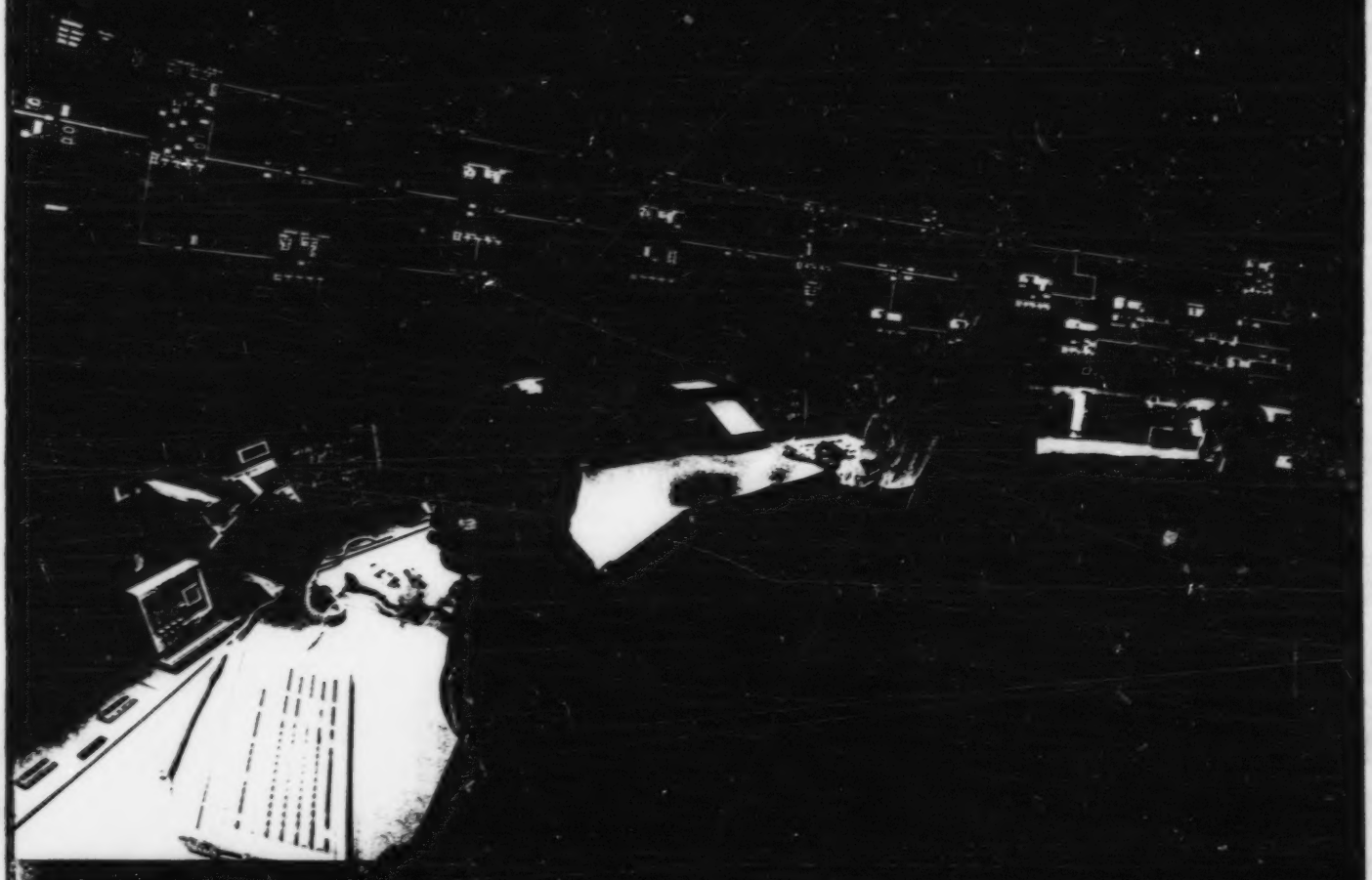
CN

# BUILDING FOR THE NINETIES



ANNUAL REPORT 1990

91-05647/

Canadian National, a commercial Crown corporation owned by the Government of Canada, offers rail-based freight transportation and distribution services throughout Canada. Its wholly owned subsidiary, the Grand Trunk Corporation, markets rail freight service in the United States.

Non-transportation businesses making up the CN Enterprises group include CN Real Estate, responsible for managing and developing Canadian National's property assets; CN Exploration, the company's oil and gas unit in Western Canada; the CN Tower in Toronto; and Canac International, a transportation and telecommunications consulting service.

CN's mission is to meet customers' transportation and distribution needs by being the best at moving their goods on time, safely, and damage-free.

In carrying out the mission, CN people are setting their sights on a vision of what CN is becoming: close to its customers, first in service, first in quality, first in safety, environmentally responsible, cost-competitive and financially sound, and a challenging and fulfilling place to work.

Although centred on the railway, CN's mission and vision apply throughout the company, guiding the Grand Trunk Corporation and all the units of the Enterprises group.

COVER NOTE

HIGHLY SKILLED STAFF, ASSISTED BY SPACE-AGE INFORMATION TECHNOLOGY, PLAN AND COORDINATE TRAIN MOVEMENTS ACROSS CANADA FROM CN'S NEW OPERATIONS MANAGEMENT CENTRE IN MONTREAL. THE MOST ADVANCED CENTRE OF ITS KIND IN THE WORLD, OMC ENABLES CN TO ENHANCE SIGNIFICANTLY THE QUALITY, RELIABILITY AND SAFETY OF ITS DISTRIBUTION SERVICES TO CANADIAN SHIPPERS.

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($ MILLIONS UNLESS OTHERWISE INDICATED)

## Five Year Financial and Statistical Summary

| | 1990 | 1989 | 1988 | 1987 | 1986 |
|---|---|---|---|---|---|
| **Operations** | | | | | |
| Revenues | $4,077.8 | $4,202.0 | $4,673.1 | $4,784.1 | $4,873.1 |
| Operating income | $ 163.4 | $ 396.3 | $ 546.4 | $ 487.4 | $ 279.4 |
| Interest expense – net | $ 207.4 | $ 199.2 | $ 300.5 | $ 371.9 | $ 382.3 |
| Net income (loss) | $ 7.7 | $ 205.8 | $ 282.7 | $ 120.6 | $ (86.3) |
| Dividend | $ 1.5 | $ 41.2 | $ 56.5 | $ 24.1* | $ – |
| Return on average investment % | 4.0 | 8.4 | 10.3 | 7.9 | 4.6 |
| Return on average equity % | 0.2 | 6.0 | 8.7 | 4.0 | – |
| **Capital Expenditures** | | | | | |
| Property and equipment | $ 327.2 | $ 371.0 | $ 386.3 | $ 482.1 | $ 484.1 |
| **Assets and Working Capital** | | | | | |
| Current assets | $ 989.7 | $1,082.5 | $ 945.7 | $ 965.8 | $1,124.6 |
| Working capital deficiency | $ 317.5 | $ 139.0 | $ 194.0 | $ 485.4 | $ 373.6 |
| Properties | $5,809.9 | $5,814.1 | $5,770.4 | $6,212.5 | $6,248.5 |
| Total assets | $7,028.3 | $7,105.4 | $6,906.0 | $7,593.6 | $7,842.6 |
| **Capital Structure** | | | | | |
| Long-term debt (including current portion) | $1,859.5 | $1,929.9 | $2,014.9 | $2,936.9 | $3,358.3 |
| Equity | $3,545.6 | $3,539.5 | $3,374.9 | $3,101.1 | $3,004.6 |
| Debt ratio % | 34.4 | 35.3 | 37.4 | 48.6 | 52.8 |
| **Traffic** | | | | | |
| Revenue ton miles freight (billions) | 94.1 | 96.3 | 104.5 | 101.7 | 94.2 |
| **Employees** | | | | | |
| Average number for year | 39,091 | 40,934 | 43,933** | 50,862 | 56,715 |
| Average annual wage per employee (dollars) | $ 42,963 | $ 41,241 | $ 39,042** | $ 36,706 | $ 35,680 |
| Average annual cost per employee (dollars) | $ 54,333 | $ 52,021 | $ 48,940** | $ 46,218 | $ 43,897 |
| **Expenditures in Canada** | | | | | |
| Purchases | $ 846.2 | $ 875.8 | $ 908.7 | $ 895.0 | $1,034.0 |
| Wages, salaries and fringe benefits | $1,873.1 | $1,866.2 | $1,872.6** | $1,969.8 | $2,064.1 |
| Taxes | $ 333.3 | $ 360.1 | $ 348.1 | $ 351.7 | $ 367.3 |

* REVERSED IN 1988

** EXCLUDING BUSINESS UNITS SOLD DURING 1988

The Honourable Douglas G. Lewis
Minister of Transport

Dear Mr. Minister:

On behalf of the Board of Directors, and in accordance with procedures laid down in legislation, I am pleased to submit the 1990 annual report of Canadian National.

The first year of the decade was disappointing financially, but I think it will become obvious in examining this report that much of the effort in 1990 was devoted to getting CN ready to meet the extraordinary challenges of the coming years.

More than ever, the global village is the day to day reality in which we all live. CN is an essential part of the world transportation fabric, tied into the rail network of North America and the ocean shipping lines through Canada's ports. International competition, environmental concerns, economic interdependence are all factors that will influence CN's business success in the years ahead.

From my observations, I am convinced that CN's people are prepared to meet the coming challenges, and that CN has a strong role to play in Canada's transportation future.

Brian R. D. Smith, Q.C.
Chairman

March 30, 1991

# BUILDING FOR THE 1990s

RONALD E. LAWLESS

PRESIDENT AND CHIEF EXECUTIVE OFFICER

The past year was difficult and in many ways disappointing for Canadian National. With railway earnings well below the level of recent years, net income for the corporation as a whole fell from $205.8 million in 1989 to just $7.7 million in 1990.

However, CN achieved some very real gains during 1990. We developed new plans and programs that will see the company through the current recession and position it to compete effectively in the global transportation markets of the 1990s. This report describes many of the achievements and explains how CN is building for the 1990s with realism and confidence.

## Coping with a difficult year

The difficulties encountered in 1990 can be traced in part to economic slowdown, in part to persistent problems in Canada's export trade affecting many railway customers, and in part to continuing strong competition from the trucking industry.

The first signs of economic downturn appeared in reduced railway traffic levels during the latter part of 1989, a decline that persisted and accelerated during 1990. In response, CN reduced its capital budget and cut spending throughout the system.

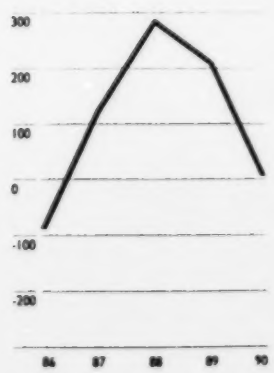
However, these measures could not fully compensate for the revenue erosion, and income from railway operations in Canada and the United States fell from a profit of $138.7 million the previous year to a loss of $110.7 million in 1990.

The railway result was offset by positive returns from the Enterprises group. In particular, CN Real Estate produced earnings of $95.7 million through excellent property management and a successful land sale program, despite the cooling economy.

Periodic dips in growth are to be expected in a free-market economy, and indeed they may present some opportunities beneficial to Canadian industry over the long term. The essential task during such times is to cope with reduced revenue and capital, build on existing assets, and plan for a future in which those assets are deployed to a fuller extent.

CN NET INCOME

IN MILLIONS OF DOLLARS




## On the road to new vitality

Facing a rapidly changing marketplace and intense competition, CN has been pursuing a new direction over the past several years to strengthen itself for a possibly rough economic roadbed.

Five years ago, the corporation was carrying an almost insupportable level of indebtedness. Much of it had accumulated during the late 1970s and early 1980s as a result of CN having to bear the cost of various imposed public duties while investing heavily in a plant expansion program. Since private equity financing is not available to CN, these expenditures had to be funded through borrowings.

Regaining financial stability was the immediate, overriding goal. It was achieved by implementing a comprehensive plan entailing stringent cost control and generation of funds through divestment of assets.

CN sold holdings in telecommunications and hotels, and applied the proceeds to debt reduction. It contained costs by investing in productivity-enhancing technology, reducing employment levels, and eliminating redundant facilities.

We knew, however, that to be a long-term business success, CN would have to undergo even more far-reaching change. Needed was a fundamental reorientation – a change in corporate culture that would make everything we do revolve around our customers and satisfying their needs.

INTERMODAL TRAIN EN ROUTE TO MAJOR MARKETS, PICTURED AT SAINT-BRUNO, QUEBEC.

FROM LEFT TO RIGHT: W.H. MORIN, GROUP VICE-PRESIDENT; J.H.D. STURGESS, SENIOR VICE-PRESIDENT AND CHIEF OPERATING OFFICER; Y.H. MASSE, SENIOR VICE-PRESIDENT AND CHIEF FINANCIAL OFFICER.

We had to break away from the idea that our only job was to run an outstanding railway. In the future, we would aim at running an outstanding business, with satisfied customers at the root of its success.

Many elements went into generating culture change at CN. We strengthened our commodity-based marketing business units; we altered the structure of operations to improve response to customer needs; and we launched total quality and customer awareness drives throughout the organization.

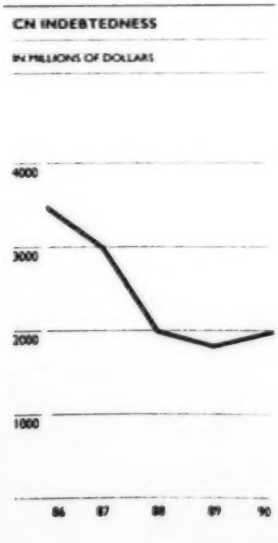
These initiatives, though long-term in nature, are already showing positive results, and it is fair to say that 1990 was truly the year of a renewed focus on the customer. The company is building on a new customer-centred culture and faces the future with renewed confidence.

## Policy review needed

Canada enters the 1990s with transportation high on the agenda of policy-makers across the country. At a time when capital resources are scarce in both the public and private sectors, and with our industries facing intensified global competition, it is clear that Canadians cannot afford to misallocate the effort and money they expend on transportation.

The dominant position freight railways once held has been severely eroded by trucking over the past four decades, in part because of the regulatory and cost advantages truckers enjoy.

The consequence is a severe imbalance in Canada's freight transportation system: publicly overfunded, overused highways, and self-funded, underused railways.
If the trend continues, the competitiveness of Canada's industrial producers could eventually be threatened.



CN presented this case when it appeared before the Royal Commission on National Passenger Transportation in November. CN's position was that since all forms of transportation are closely related, the commission should look beyond its immediate mandate and consider the impact any of its recommendations might have on the freight system.

For example, a decision to increase public highway funding, without commensurate user-pay charges, would further benefit trucking and render railways even less competitive.

Federal policy-makers should also review the position of Canadian railways vis-à-vis their U.S. counterparts. For CN, the regulatory imbalance, based on some provisions of the National Transportation Act of 1987, is particularly worrisome. Transborder traffic contributes about one third of the railway's total freight revenue, and the volume of traffic moving between the two countries is bound to increase as free trade expands.

NTA '87 gave U.S. railways greater access to Canadian rail traffic through extended interswitching and competitive line rates – advantages Canadian rail carriers do not enjoy south of the border. Furthermore, the tax burden on U.S. railways is some 45 per cent lower than that borne by Canadian rail companies.

Canada needs a strong, viable and competitive railway system to ensure that our basic resources and manufactured products can compete in domestic and global marketplaces.

CN believes that reliance on market forces is the most effective means of achieving a well-balanced and healthy transportation sector. Policies that discriminate against a single mode, or discourage its investments, make that goal more difficult, if not impossible, to attain.

## CN people, best in the business

Throughout a difficult year, CN's employees have demonstrated that they have the skills and determination to make Canadian National a long-term success.

I have been impressed by their willingness to adjust to a changing business environment and take on the problems CN faces as their personal challenges. They are making quality customer service their number one objective and contributing the energy and ideas CN needs to come out a winner.

Containing the costs of labor is essential for CN, but equally important in our drive for success is the effort each and every employee is making to produce his or her personal best on the job.

In the years to come, I know CN's people will continue to meet the challenges we face and will work together to fashion a strong CN for the 21st century.

A CN GRAIN TRAIN, HEADING FOR THE PORT OF VANCOUVER, PASSES THROUGH BLUE RIVER, BRITISH COLUMBIA.

R.E. Lawless

Ronald E. Lawless

# THE SHAPE OF THE '90s

**The railway, emerging from a year marked by sluggish business and declining revenues, has put itself into remarkably good shape to face the challenges of the 1990s.**

***"Getting close to customers means putting yourself in their shoes and making customer satisfaction your number one priority, no matter what your job might be."***
*Nick Ciolfi, assistant manager, field operations and technical services, Customer Service Centre, Toronto*

True, profit margins have been shrinking in recent years. Revenue per revenue ton mile is down some three per cent since 1985 while inflation has driven costs up by 25 per cent over that period. The railway bore the brunt of Canada's economic slowdown in 1990, with revenues off by four per cent while costs rose by six per cent.

However, CN has good reason to expect better times ahead. It is preparing for the future by pursuing two basic objectives: productivity gains through stringent cost control and technological advancement, and revenue expansion through aggressive marketing efforts to differentiate its product, increase its market share, and provide commercially viable returns.

## Customers come first

Railway customers and their markets are changing, and CN itself is rapidly adapting to new economic realities.

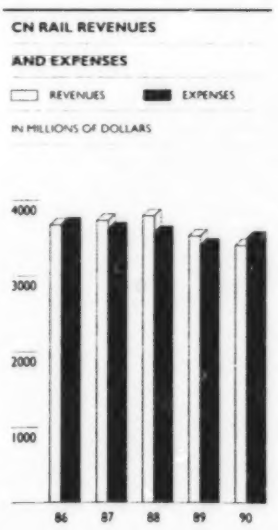
Until recent times, railway fortunes were driven largely by cycles of demand for Canada's resource products. Today, the Canadian and worldwide economies are much more complex and interdependent.

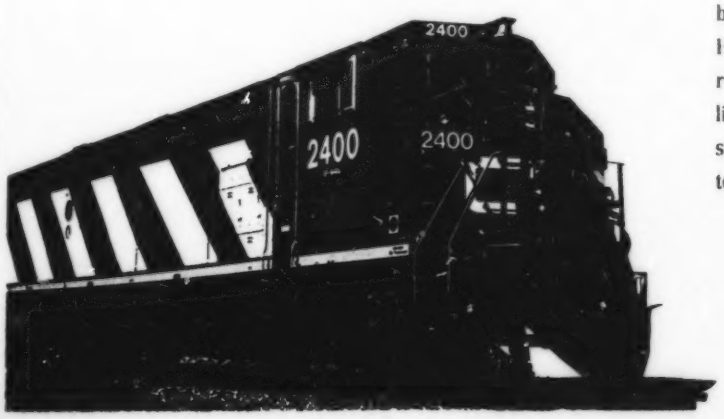
Free trade with the United States is altering production patterns here in Canada; the service sector is growing in relation to manufacturing; export markets are less certain, with the rise of powerful new trading blocs and Third World competitors; and difficult international trade negotiations are making the future of some basic Canadian commodities less assured.

Canada still needs – and will continue to need – its heavy-haul railways to move bulk resource products. However, it is clear that railway viability in the future lies in the ability to contribute services more closely tailored to customers' varying needs.

Customer commitment is at the heart of CN's marketing drive – and customer commitment means intimate knowledge of shippers' operations, their markets, and their business goals. It means looking beyond the immediate customer to the customer's customer, and knowing just how rail service can offer distribution solutions.

This philosophy is being applied assiduously in all CN's commodity sectors. In 1990, the railway sought to increase its share of major customers' transportation business and attract new



RAILWAY OF THE FUTURE — DOMESTIC CONTAINERS ARE DOUBLE-STACKED ABOARD EXTENDED-LENGTH "FIVE-PAK" CARS AT THE MONTERM INTERMODAL TERMINAL IN MONTREAL FOR FAST, ECONOMICAL SHIPMENT VIA CN'S LASER TRAINS.

clients by promoting the benefits of rail distribution. Marketing and operations staff came up with innovative service arrangements and attractive pricing to enhance customers' competitive positions and help retain their business for the railway.

Some evidence that the drive is paying off came early in the year when Dow Chemical Canada of Fort Saskatchewan, Alberta, conferred on the railway its Transportation Partnership Award. As well, the Polyolefins Division of Union Carbide cited CN as its Quality Rail Carrier for 1989.

The ability to negotiate confidential contracts with individual shippers is proving to be an important factor in achieving maximum customer satisfaction and commitment to CN services. Some 1,900 contracts were in effect by the end of 1990, committing the railway to meet detailed service specifications worked out with customers.

CN's Customer Service Plans cover all aspects of service delivery to individual customers, specifying equipment needs, and traffic patterns and timing. Service plans were applied to more of CN's major customers in 1990, and further expansion will take place over the next few years.

Reliability – consistent on-time performance – is the key to satisfying rail shippers. Through Customer Service Plans, and for all its customer base, CN closely monitors its performance, assessing it constantly from the customer's standpoint.

Close contact with customers is vital to knowing and meeting their needs. With that goal in mind, two of CN's eight commodity-based marketing business units were relocated during 1990. The lumber business unit was shifted to Vancouver for better contact with major producers, while the coal, sulphur and potash unit set up shop in Calgary.

## Capital investment for future growth

Current financial circumstances have required careful scrutiny and reduction of the railway's capital budget. However, CN is continuing a prudent spending program intended to generate productivity gains and improve the railway's competitiveness and quality of service to customers.

Capital funds – some $300 million in 1990 – go primarily towards maintaining CN's basic plant and facilities to a level consistent with high levels of safety and service quality.

Strategic investments in new equipment are paying off in lower operating costs and greater flexibility to serve customers' needs.

CN took delivery of 30 new highly productive, fuel-efficient locomotives from General Electric to haul time-sensitive intermodal cargo in Eastern Canada. Rail car acquisitions included 683 covered hopper cars for grain, potash and fertilizer; 160 fully-enclosed automobile transporters; 100 rail cars capable of carrying both highway trailers and double-stacked containers, as well as 500 domestic containers and 440 chassis.

## Gearing up for intermodal expansion

Combining the long-haul efficiency of trains with the short-haul flexibility of trucks gives many shippers top value for their transportation dollars. Intermodal transportation helps minimize highway damage and congestion, and enhances road safety, by reducing the number of heavy trucks travelling Canada's major arteries. Rail-based service also offers truckers an economical means of moving their trailers over long distances.

CN demonstrated its confidence in intermodalism by investing heavily in new services, plant and equipment during 1990.

- CN paved the way for a domestic double-stack container service by acquiring new equipment and assigning it to time-sensitive intermodal trains between Moncton, Montreal and Toronto. The company spent $2 million on the track clearances necessary for domestic double-stack operations in that corridor.

Container double-stacking keeps operating costs at a lower level, in line with intermodal's chief competitor, intercity trucking. CN is looking at eventual expansion of double-stack services coast to coast.

- CN is committing renewed attention and resources to supplying top-quality intermodal services to the Port of Halifax, now facing powerful competition from U.S. East Coast ports. Container double-stacking, linking this important and efficient Canadian gateway with the North American industrial heartland, is one of the means CN is exploring to provide shippers using Halifax

***"CN service reliability depends on how well we do our jobs. For me, that means helping to keep train equipment running smoothly and safely."***

*Joe McLeod, carman, Transcona Car Shop, Winnipeg.*

with greater value and thus improve the port's competitive position.

- The railway inaugurated a new intermodal train service between Toronto and Edmonton, and began operating a weekly double-stack container service between Vancouver and the Toronto and Montreal areas on behalf of Orient Overseas Container Lines of Hong Kong.
- Construction of a $19-million intermodal terminal is under way at Surrey, B.C., and the railway is working with the Port of Vancouver to attract more container traffic.
- CN received regulatory approval to take over management of the Chicago Railport intermodal terminal from its subsidiary, the Grand Trunk Western. The move will improve CN's import-export service coordination in that valuable market.

## Technology paying off for customers

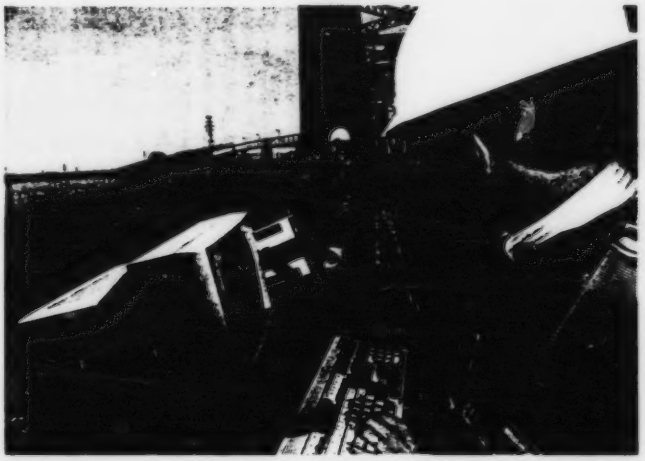
In many respects, railways and advanced computer technology are made for each other. Many of 1990's investments went to refining and introducing innovative systems that will improve CN's responsiveness to the needs of its customers, now and in the years ahead.

- A $7-million Operations Management Centre (OMC) in Montreal, due to come on stream early in 1991, will bring together all elements involving the movement of trains, from the assignment of locomotives to the coordination of train movements throughout the network. OMC will enhance on-time performance and give planners the information they need to keep trains running smoothly.
- CN is leading the way in an industry-wide initiative to bring the most sophisticated technology to railway operations. Advanced Train Control Systems (ATCS) will improve safety levels, lower costs, and increase the reliability of service to customers.

During 1990, CN tested prototypes of various ATCS components on its Hagersville subdivision near Brantford, Ontario, and proceeded with installation of a working system on 301 kilometres of the British Columbia North Line between Prince George, B.C., and Jasper, Alberta. The system will go into operation during 1991 – the first of its kind in North America.

- CN is testing a companion program, the Work Order Reporting System, on its Kingston subdivision. The system allows traffic controllers and train crews to exchange information on train movement and traffic directly by computer, speeding up responsiveness to customers' requirements.
- End-of-train electronic monitoring units began to replace cabooses on CN's freight trains early in the year, and the conversion to efficient, cost-saving cabooseless operations was soon well under way.
- A track maintenance mechanization program, implemented the previous year, generated savings and safety enhancement in 1990.

All these initiatives, and many more, are helping CN meet its customers' transportation and distribution needs by becoming the best at moving goods on time, safely, and damage-free.



CN DESIGN ENGINEER DAVID BRADSHAW (FOREGROUND) CHECKS THE HEALTH OF MONTREAL'S VICTORIA BRIDGE, USING NEW COMPUTER TECHNOLOGY TO PINPOINT STRESS AREAS PRECISELY.

## Core network taking shape

Railways throughout North America have been rationalizing their networks over the past few decades as highway expansion, and consequent growth in trucking competition, made many lines redundant and uneconomic.

Regulatory constraint has limited the ability of Canadian railways to keep pace with U.S. competitors and shifting traffic patterns. Consequently, traffic density on CN's network is now considerably lower than that of comparable U.S. carriers.

Right now, CN has much more trackage than it needs to serve existing and potential customers, a situation that keeps operating costs higher than those of competitors. The high overhead involved in operating low-density lines is reflected in the company's net income.

CN envisages operating a high-density core network and key secondary lines, linking major production centres from coast to coast, with feeder systems – rail, road, or an intermodal combination – appropriate to the economies of the various regions of Canada.

To eliminate or reduce the high costs associated with underused lines, a number of approaches are being pursued. One of the possibilities is development of independently owned short-line railways.

CN found a buyer in 1990 for its Goderich and Exeter subdivisions in Railtex Inc. of San Antonio, Texas. With 112 kilometres of track in southwestern Ontario, the new railway will continue to serve customers along the line and feed traffic to CN's main-line network.

Transferring lines to other railways and joint track usage may also improve operational efficiency or eliminate duplicate trackage. Early in 1990, CN negotiated the transfer of its 240-kilometre line between Cochrane and Calstock to the Ontario Northland Railway.

CN reached agreement with CP Rail to take over a 152-kilometre CP line in northern Saskatchewan in exchange for 145 kilometres of CN trackage in the south. The two railways are discussing duplicate trackage in the Ottawa Valley with a view to accommodating traffic on one route.

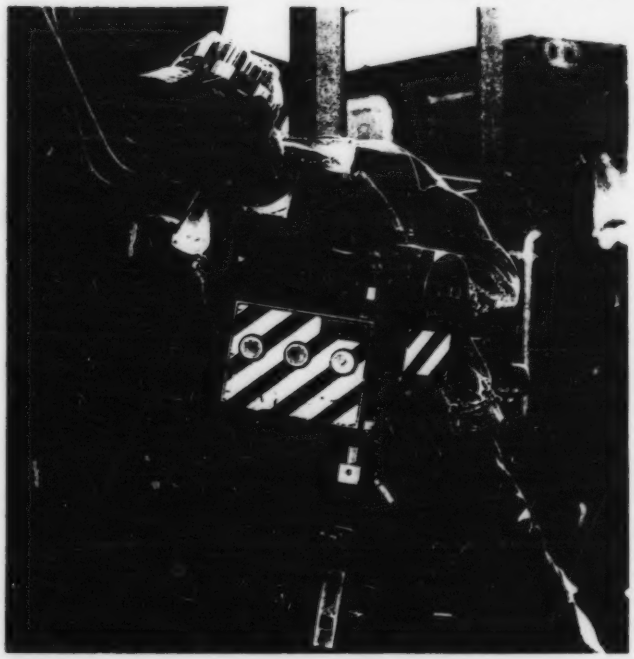
## Grand Trunk key to U.S. markets

CN's railway subsidiary in the United States, the Grand Trunk Corporation (GTC), is strategically placed to play an important role for Canadian National in the free trade era.

The corporation comprises three units: the Grand Trunk Western Railroad based in Detroit and serving the U.S. heartland; the Central Vermont Railway with headquarters in St. Albans, Vermont, serving northeastern states; and the Duluth, Winnipeg and Pacific Railway running from the U.S. border in western Ontario to Duluth, Minnesota.

The bulk of Grand Trunk Western business is in automotive traffic and intermodal shipments. The recession struck the auto market particularly severely, and GTC's results for 1990 reflected that fact in a loss of $10.6 million.

However, a sharp focus on quality customer service over the past few years has led to the creation of imaginative new train services that are proving popular with shippers. Trend-setting agreements with labor unions are enhancing the railway's productivity and competitiveness.



GT CORPORATION TRAINS GO HIGH-TECH — CARMAN BILL MARCINIAK INSTALLS AN END-OF-TRAIN MONITORING UNIT ON A DULUTH, WINNIPEG AND PACIFIC TRAIN. THE ELECTRONIC UNITS ARE TAKING OVER FROM THE CABOOSE TO IMPROVE THE RAILWAY'S OPERATING EFFICIENCY WITHOUT COMPROMISING SAFETY.

# HOW CN BECAME FIRST IN SAFETY

**Canadian National led the North American railway industry with the lowest rate of train and yard accidents in 1990, and had the second-best record in employee injuries.**

How did this achievement come about? The answer is simple: CN made leadership in safety a top priority – and concentrated on developing the technology, the systems and the attitudes that would make that standing possible.

Safe operations are reliable operations, and service reliability is perhaps the railway's biggest selling point. Today the emphasis is on prevention – promoting safe practices that will prevent incidents costly to the railway in financial terms and in customer satisfaction.

Over the past decade, and particularly during the past few years, CN stepped up investments in safety-enhancing technology, improved the monitoring and analysis of track and equipment conditions, and more actively promoted a safety-first mentality among its employees.

The sophisticated rail traffic control systems CN is testing and implementing are making train operations safer than ever before. Track geometry cars, using advanced electronic monitoring systems, travel the system regularly to detect faults that might cause derailments.

The materials that make up CN's plant and equipment are examined scrupulously to ensure they are in top condition, free from defects. The railway works with suppliers and insists that their products meet the high standards specified in sales agreements.

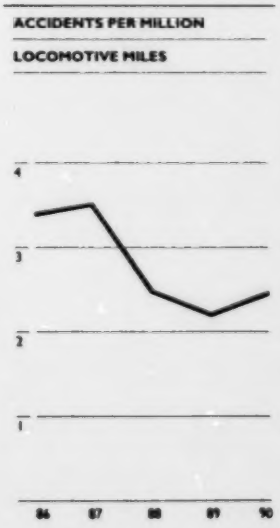
The safety-first attitude of CN employees originates in the workplace with health and safety committees that meet regularly to discuss occupational safety issues. A new coordinated, computerized workplace inspection system facilitates the identification and correction of unsafe work habits or hazardous situations.

The alertness and fitness of railway employees is essential to maintaining a top safety record. In 1990, CN and five of its labor unions agreed on a new program to help employees in safety-sensitive positions remain free of the influence of drugs or alcohol while on the job.

The program, administered by a joint union-management committee, includes an enhanced employee assistance policy and training for managers and supervisors on how to deal with substance abuse.

***"Our job is to promote safe railroading by making sure that the steel and components used in CN's track and equipment are strong and defect-free."***

*Bill Landers, system manager, metallurgy and quality assurance departments at CN's Technical Research Centre, Saint-Laurent, Quebec.*



**The railway clearly has a contribution to make in the preservation of environmental integrity. Highly energy-efficient, trains use less than a third of the fuel consumed by trucks to haul the same amount of freight.**

# A ROLE FOR CN IN ENVIRONMENTAL PROTECTION

***"All of us have a stake in preserving a healthy environment. At CN, environmental protection forms an essential part of the way we do business – it sharpens our competitive edge."***
*Mary Taylor, regional manager, sales and services, marketing, Moncton.*

Lower fuel consumption means lower exhaust emissions when goods move by rail. CN is building on this basic strength by replacing older locomotives with new fuel-efficient, less-polluting units and other fuel-saving initiatives.

The railway is also the ideal mode for handling cargo that must be moved with maximum safety over long distances. Such cargo includes dangerous goods, hazardous waste products, and municipal trash.

Dedicated rights-of-way, stringent regulation, and almost fail-safe traffic control systems ensure that these materials are handled at low risk to the environment. Currently, CN has a proposal before the City of Toronto to transport municipal waste away from the city for disposal or recycling.

The railway's technical research branch carries out studies and tests in environmental matters, and CN also provides financial support to other agencies; $250,000 is being donated over five years to the University of Alberta to purchase equipment and develop new techniques for analysing and evaluating the health consequences of contaminants in air, water, soil, and living organisms.

Nevertheless, like most industrial corporations, CN is aware that its operations can affect environmental integrity.

Consequently, the company is reducing any air, water, soil, and noise pollution caused by its operations. It has reviewed and audited its policies and practices and is updating them in the light of today's environmental concerns.

SAFE TRANSPORTATION FOR SPECIAL COMMODITIES — A TRAINLOAD OF CHEMICAL PRODUCTS MOVES THROUGH THE BOSTON BAR AREA OF BRITISH COLUMBIA ALONG THE RAILWAY'S DEDICATED RIGHT-OF-WAY.

# CN... TRANSPORTATION AND THEN SOME

**Canadian National must maximize the value and earning potential of all its assets to keep the corporation strong and viable in today's transportation marketplace.**

The Enterprises group of non-transportation businesses is providing the kind of solid returns CN needs to do just that.

CN Real Estate, the most important of these non-transportation businesses, maintained a high level of performance in 1990, with earnings of $95.7 million.

With its partner, The Bentall Group, CN Real Estate opened Manitoba's tallest commercial office tower, the TD Centre, in June. In October, the company went on to open the renovated and expanded Midtown Plaza in Saskatoon with Cadillac Fairview and Eaton's.

Pre-development work continued throughout the year on Vancouver's Custom House and on Montreal's Peel/St. Jacques lands. The company announced a shopping mall development on CN's former city yard site in Edmonton, and a residential development on the Dunvegan yard in the northern part of the city.

In Toronto, the year was characterized by intense political activity around CityPlace, Canada's largest redevelopment project. Late in the year, CN Real Estate reached agreement with the City of Toronto on the sale of its Ataratiri lands for a major mixed housing project.

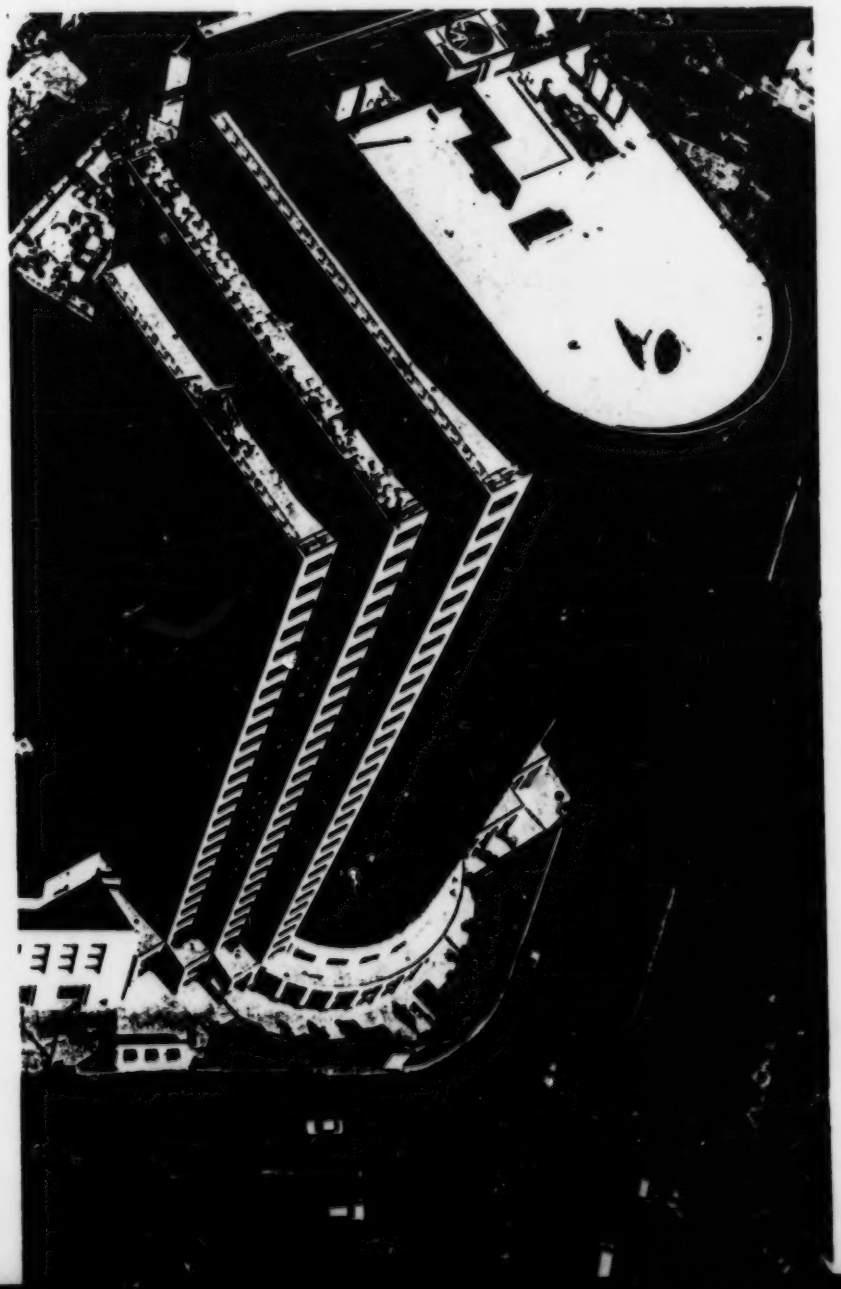
A decline in CN Real Estate earnings is expected through much of the next few years, largely because of a decrease in land asset sales in a depressed market. However, the decline will be partly offset by revenue from property operations, which will increase as development projects come on stream.

CN Exploration, the company's oil and gas business, participated in the drilling of 57 wells in Saskatchewan, resulting in the completion of 40 oil wells and four gas wells. The company produced 1.40 million barrels of oil during the year, up from the 1.29 million produced in 1989.

Canac International and CN Communications are the two divisions through which CN offers international consulting and contracting services. Canac has been involved in more than 400 projects in some 50 countries since it was established almost 20 years ago.

Toronto's CN Tower, one of Canada's most popular tourist attractions, welcomed 1.5 million visitors from all over the world in 1990, slightly less than the previous year, largely because of the unfavorable economic climate.

- WINNIPEG'S IMPRESSIVE NEW TD CENTRE STANDS AS MANITOBA'S TALLEST BUILDING, MARKING THE FIRST PHASE OF CN REAL ESTATE'S EXTENSIVE COMMERCIAL DEVELOPMENT PROJECT AT PORTAGE AND MAIN.



**In the competitive '90s, fostering the skills and motivation of employees, and creating a fulfilling work environment, rank high on the list of business challenges.**

# BUILDING SKILLS FOR THE '90s

***"To make CN the best in the business, all of us – from top management on down – have to work as a team and produce quality service for our customers."***

*Mary Liew, stores attendant, Calder Diesel Store, Edmonton.*

Technological development and growing competition have necessitated a steady downward trend in the level of employment at CN. But highly skilled and motivated employees are absolutely essential to achievement of good company performance now and ability to build for the future.

That is why CN is concentrating on developing the skills of its people and on rewarding them well for their contributions to the company's success.

Spending on training rose by 20 per cent in 1990 to almost four per cent of the company's $1.4-billion payroll. Each program has as its premise the vital importance of meeting customers' needs with quality service.

## Quality service for customer satisfaction

In the fall of 1988, CN launched a comprehensive process to make customer commitment and quality service the primary objective of every employee. The Quality process has already produced positive results in terms of customer satisfaction and employee morale.

CN sharpened its focus on Quality in 1990 so that results could be generated more quickly. Quality principles are now being applied to specific projects so that people trained in the process can use their new knowledge on the job immediately and see the benefits personally. At the same time, CN gave its Quality effort a higher profile by creating a new top-level position, vice-president of quality.

CN people are responding enthusiastically to the Quality process, demonstrating their willingness to help CN succeed and their desire to make their own jobs more meaningful and satisfying.

## Equity means more than fairness

Equity in the workplace is more than a matter of fair and equal treatment of all employees and potential employees. It is a competitive imperative for companies determined to hire and promote the most qualified people available.

Because its workforce is shrinking, CN does not have the flexibility to make progress as rapidly as it would like. Nonetheless, the company ensures that members of the four target groups (women, visible minorities, aboriginals, and persons with disabilities) are not overlooked. It works actively with organizations that represent them when it is recruiting new employees. As a result, their presence in the workforce is gradually but steadily increasing.

CN offers a series of scholarships for women who want to enter technical fields, and another for native students pursuing transportation-related programs at the post-secondary level.

QUALITY ACTION TEAM AT WORK — A TEAM OF EMPLOYEES, WITH THE INNOVATIVE MACHINE AND TECHNIQUES THEY DEVELOPED, REMOVES TRACK FROM AN ABANDONED SUBDIVISION IN MANITOBA. THANKS TO THEIR INGENUITY, EFFICIENCY IS UP AND COSTS ARE DOWN.

The company is working to accommodate the special needs of its employees in the workplace. At work sites across the country, for example, installations that pose an obstacle to people with physical disabilities are being altered, removed or replaced.

## Rightsizing continues

The need to bring costs down to a competitive level means that CN must continue to adjust its workforce while maintaining a high level of quality service. Despite significant reductions in recent years, CN still has the lowest rate of revenue ton miles per employee among major North American railways, the standard measure of productivity in the industry.

A comparative study of staff levels in 1990 revealed that CN employs considerably more administrative people than its railway competitors. This finding led CN to offer a voluntary separation plan to its 7,300 management and administrative personnel in October.

The plan, which terminated January 31, 1991, was designed to encourage up to 1,500 people to leave CN through early retirement or resignation. The plan involved enriched severance packages, improved retirement provisions, and other benefits such as financial and employment counselling. While preserving safety and service quality, the plan was designed to eliminate redundant activities and areas of duplication.

JEAN-MARC LÉGER, INSTRUCTOR AT CN'S SCHOOL FOR LOCOMOTIVE ENGINEERS IN GIMLI, MANITOBA, DELVES INTO THE INTRICACIES OF RUNNING THE ELECTRONIC RAILWAY.

## Union cooperation needed

As CN enters the competitive 1990s, it is perhaps more important than at any time in the past for management and labor unions to work together in the best interests of all.

Unionized employees and their representatives have shown that they understand CN's competitive problems. Their understanding and support is invaluable and much appreciated.

CN needs a flexible, versatile workforce that can quickly adjust to service requirements on a timely basis. That was the goal when the company applied to the Canada Labour Relations Board in 1990 for a review of the certifications of the railway's operating and equipment maintenance unions.

The merging of separate bargaining units covering employees with common interests and skills would facilitate the negotiation of more flexible working conditions, reduce disputes over union jurisdiction, and broaden the range of jobs available under each collective agreement. A board decision is expected in 1991.

*"In the shops, and everywhere across the line, we're learning we can help CN succeed by putting the customer first."*

*Mario Dagenais, machinist, Moüre Power Shop, Montreal.*

# THE WAY AHEAD AS CN SEES IT

**Canadian National can point to significant progress toward many of its goals as it enters the 1990s.**

The company has succeeded in keeping costs under control, to the extent of its freedom to do so. It has made productivity gains by better deployment of assets and by adopting new technology. Its customer-centred marketing drive is beginning to pay off in greater customer satisfaction and better opportunities to increase market share.

However, competitors are also moving ahead. Consequently, in the years ahead, CN must hold to the steady, determined course it has chosen to pursue.

Success depends in part on unpredictable external circumstances and events over which CN has little or no control and which could have a significant impact on the company's fortunes.

Swings in the economy are inevitable, though often difficult to foresee.

The current recession may prove to be longer, deeper and more widespread than anticipated.

Canada's constitutional turmoil holds the risk of economic setback.

Further productivity gains by the trucking industry could worsen the railway's competitive position.

However, despite external unknowns, and despite the need to maintain rigorous cost control, CN knows that its success depends largely on its performance in the marketplace.

Close partnership with customers is ultimately the route to CN's survival and ability to fulfill its mission. In the coming years, CN will continue the current drive to become more market-focused, responsive and efficient, delivering top value to its customers and its shareholder.

It will concentrate on maintaining a sound financial base so that funds are available for technological advances, service enhancement, and fair compensation to employees.

The current corporate plan is based on the twin goals of cost control and quality service. If CN meets those goals consistently, the company will emerge strengthened for the balance of the 1990s and positioned to play a vital role in the global transportation market.

TEAMWORK ON A DISTRIBUTION PROBLEM PAID OFF FOR HEINZ, ITS RETAILER CUSTOMERS, AND CN IN A CREATIVE SOLUTION THAT IS GETTING THE RIGHT PRODUCTS TO MARKET

# DIRECTORS

AS AT DECEMBER 31, 1990

**B.R.D. Smith, Q.C.**
Chairman
Victoria, British Columbia
(2)

**A.J. Bentley**
Saskatoon, Saskatchewan
(3) (4)

**J. Brouwer**
West Vancouver, British Columbia
(2) (4)

**G.T.H. Cooper, Q.C.**
Halifax, Nova Scotia
(1) (3)

**G. Coulombe**
Montreal, Quebec
(1) (3) (4)

**E. Demkiw**
Vegreville, Alberta
(2) (3) (4)

**R.E. Lawless**
President and Chief Executive Officer
Beaconsfield, Quebec
(2) (3)

**E.A. Mascoll**
Toronto, Ontario
(2) (4)

**M. Mayer**
Montreal, Quebec
(3) (5)
APPOINTED MAY 5, 1990

**Y. Poitras**
St. Quentin, New Brunswick
(1) (4) (5)

**F.J. Ryan**
St. John's, Newfoundland
(1) (4) (5)

**B.O'N. Gallery**
END OF TERM
FEBRUARY 1, 1990

**J. Johnson**
END OF TERM
SEPTEMBER 27, 1990

(1) MEMBER OF THE AUDIT COMMITTEE

(2) MEMBER OF THE COMPENSATION COMMITTEE

(3) MEMBER OF THE INVESTMENT COMMITTEE

(4) MEMBER OF THE REAL ESTATE COMMITTEE

(5) MEMBER OF THE SOCIAL POLICY COMMITTEE

STANDING:
Y. POITRAS, G. COULOMBE
A.J. BENTLEY, G.T.H. COOPER
F.J. RYAN, M. MAYER
J. BROUWER, E.A. MASCOLL

SEATED:
R.E. LAWLESS, E. DEMKIW
J. JOHNSON, B.R.D. SMITH

## OFFICERS

AS AT DECEMBER 31, 1990

**B.R.D. Smith, Q.C.**
Chairman

**R.E. Lawless**
President and Chief
Executive Officer

**M.A. Blackwell**
Vice-President
Atlantic Region

**R. Boudreau, Q.C.**
Vice-President - Law

**F.D. Campbell**
Vice-President
Prairie Region

**T. Cedraschi**
President and Chief
Executive Officer
CN Investment Division

**G.C. Church**
Treasurer

**P.A. Clarke**
Senior Vice-President
Marketing

**J.C.B. Cullen**
Acting President
CN Communications

**A.E. Deegan**
Vice-President
Great Lakes Region

**M.L. De Pellegrin**
President and Chief
Executive Officer
Canac International Inc.

**B.E. Ducey**
Vice-President
Public Affairs and Advertising

**A.J. Gillies**
Vice-President
Intermodal

**J.D. Guppy**
Vice-President
Marketing

**B.E. Horsman**
Vice-President
Planning and Co-ordination

**J.P. Kelsall**
Senior Vice-President
Operations

**J.R. Lagacé**
Vice-President
St. Lawrence Region

**J.P. Laroche**
Vice-President
Quality

**G.L. Maas**
President
Grand Trunk Corporation

**I.G. MacDonald**
Vice-President
Financial Planning

**D.P. MacKinnon**
Vice-President and
Secretary of the Company

**G. Maroulis**
Vice-President
Internal Audit

**Y.H. Masse**
Senior Vice-President and
Chief Financial Officer

**R.D. McGrath**
Vice-President
Accounting and Comptroller

**W.H. Morin**
Group Vice-President

**H.F. Muchnick**
President
CN Tower Limited

**D.J. Parsons**
Vice-President
Purchases and Materials

**L. Piché**
Vice-President
Human Resources

**A.R. Pozniak**
Vice-President
Information Systems

**J.H.D. Sturgess**
Senior Vice-President and
Chief Operating Officer

**H.D. Tipple**
President
CN Real Estate

**D.E. Todd**
Vice-President
Government Affairs

**W.H. Waddell**
President
CN Exploration Inc.

**R.A. Walker**
Senior Vice-President
Western Canada

# COMPANIES

COMPANIES INCLUDED IN THE CONSOLIDATED FINANCIAL STATEMENTS OF THE CANADIAN NATIONAL RAILWAY SYSTEM AS AT DECEMBER 31, 1990

## Consolidated Companies

Autoport Limited

Canac International Inc.

Canac International Ltd.

The Canada and Gulf Terminal Railway Company

Canadian National Express Company

Canadian National Railway Company

The Canadian National Railways Securities Trust

Canadian National Steamship Company, Limited

Canadian National Telegraph Company

Canadian National Transfer Company Limited

Canadian National Transportation, Limited

The Canadian Northern Quebec Railway Company

Canat Limited

Canaven Limited

Central Vermont Railway, Inc.

Chapman Transport Limited

CN Exploration Inc.

C.N. (France) S.A.

CNM Inc.

CN Tower Limited

CN Transactions Inc.

Domestic Four Leasing Corporation

Domestic Three Leasing Corporation

Duluth, Winnipeg and Pacific Railway Company

E I D Electronic Identification Systems Ltd.

Empire Freightways Limited

Grand Trunk Corporation

Grand Trunk Land Development Corporation

Grand Trunk Radio Communications, Inc.

Grand Trunk Western Railroad Company

The Great North Western Telegraph Company of Canada

The Minnesota and Manitoba Railroad Company

The Minnesota and Ontario Bridge Company

Mount Royal Tunnel and Terminal Company, Limited

The Northern Consolidated Holding Company Limited

173335 Canada Inc.

The Quebec and Lake St. John Railway Company

Royal Transportation Limited

## Jointly-operated and other companies in which the System has investments

The Belt Railway Company of Chicago

The Canada Southern Railway Company

Canaprev Inc.

Chicago and Western Indiana Railroad Company

Compagnie de gestion de Matane Inc.

Corporation de Chauffage Urbain de Montréal

Detroit River Tunnel Company

Dome Consortium Investments Inc.

Domestic Two Leasing Corporation

Eurocanadian Shipholdings Limited

Fort Point Holdings Ltd.

Halifax Industries (Holdings) Limited

Halterm Limited

Lakespan Marine Inc.

Portage & Main Development Ltd.

The Public Markets, Limited

Railroad Association Insurance, Ltd.

Seabase Limited

Shawinigan Terminal Railway Company

Société du port ferroviaire de Baie Comeau-Hauterive

Telesat Canada

The Toronto Terminals Railway Company Limited

Trailer Train Company

IN ADDITION, THE PROPERTY OF THE CANADIAN GOVERNMENT RAILWAYS IS ENTRUSTED TO THE CANADIAN NATIONAL RAILWAY COMPANY AS PART OF THE SYSTEM.

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## RESULTS OF OPERATIONS

System net income totalled $7.7 million in 1990, $205.8 million in 1989 and $282.7 million in 1988. The 1990 decline reflects depressed economic conditions and reduced business activity in Canada and the United States. The rail sector was particularly hard hit, with rail operations incurring a loss of $110.7 million in 1990 compared with an income of $138.7 million in 1989. The rail loss was offset by income of $116.4 million from the Enterprises group. CN Real Estate, which had higher profits on land sales, and CN Exploration, which benefited from oil price increases, had improved results compared with 1989. However, reduced income from Other activities within Enterprises lowered the Group's results from last year's level by $1.7 million.

The 1989 decline in income was due mainly to lower income from Canadian rail operations offset to some extent by improved results from the Enterprises group and a decline in interest expense of $101.3 million from 1988 resulting from the Company's debt reduction program. There were also factors that affected net income in 1988 for which there were no comparable items in 1989. These included income of $104.1 million from discontinued operations and a premium of $111.1 million on the early extinguishment of long-term debt. In addition, in 1989, losses carried forward from prior years only partly reduced income taxes. As a result, net income taxes charged against earnings amounted to $51.0 million in 1989 compared with $4.3 million in 1988.

The results for each division, which are discussed below, include the assignment of interest expense. This expense aggregated $207.4 million for the System in 1990, $199.2 million in 1989 and $300.5 million in 1988.

## CN RAIL

CN Rail had a loss of $100.2 million in 1990, compared with income of $125.0 million in 1989 and $220.7 million in 1988. Lower freight revenue was the main factor in the reduced results in both 1990 and 1989.

Railway operating revenues totalled $3,398.2 million in 1990, down $130.2 million from 1989 and $393.9 million from 1988. Freight revenues were down $121.3 million from 1989 mainly because of lower traffic volumes. Revenue gains were recorded in grain, sulphur, potash, petroleum and chemicals. These were more than offset, however, by lower revenues in all other commodity groups caused by the reduced level of construction and other business activity in the current recession. Despite an increase of $15.9 million resulting from the settlement of disputes relating to the prior operating agreement, revenues from the contract with VIA Rail Canada Inc. (VIA) declined by $10.1 million due to lower workloads brought about by a cutback in service at VIA. Revenues from all other sources increased by $1.2 million.

Freight revenues in 1989 were down $257.6 million from 1988, principally because of lower traffic volumes. Except for intermodal, and ores, minerals & metals, all commodity groups registered revenue declines. The most significant decreases occurred in grain, sulphur and potash traffic. Non-freight revenues were also down from 1988 levels. Revenues from the contract with VIA declined by $8.7 million due to lower workloads. Subsidy revenues and receipts from U.S. currency exchange on interline freight also decreased.

Expenses in 1990 were $3,498.3 million, $95.0 million higher than 1989, but $73.1 million lower than 1988. Contributing to the 1990 increase were separation costs incurred as a result of an arbitration award, a rise in fuel prices, downsizing costs, higher equipment leasing expenses and increases in taxes and interest. The 1989 expense reduction of $168.1 million resulted from decreased train operation and maintenance costs, as well as lower interest, taxes and pensions.

## GRAND TRUNK CORPORATION

Grand Trunk Corporation incurred a loss of $10.6 million in 1990, compared with income of $13.7 million in 1989 and $12.9 million in 1988. The main factor in the 1990 loss was lower traffic volume which could not be matched by corresponding expense reductions because of inflationary pressure on expenses. Increased other income and lower interest costs were the principal contributors to the 1989 betterment.

Revenues totalled $431.1 million, down $30.2 million from 1989 and $46.7 million from 1988. The 1990 revenue decline reflected lower traffic volumes caused by recessionary conditions, particularly in the automotive and construction markets. The lower revenue in 1989 was due mainly to the effect of the strengthening Canadian dollar on the conversion of U.S. dollar amounts.

Expenses amounted to $441.7 million in 1990, $447.6 million in 1989 and $464.9 million in 1988. The $5.9 million reduction in expenses in 1990 was due mainly to volume related savings in the areas of train crew labour, carhire and fuel consumption, moderated to some extent by inflation and severance programs costs. The $17.3 million reduction in expenses in 1989 was caused by the strengthening of the Canadian dollar and a charge for employee separation in 1988, the benefits of which were felt mostly in 1989.

## ENTERPRISES GROUP

### CN Real Estate

Income from CN Real Estate amounted to $95.7 million in 1990, up $2.7 million from 1989 and $48.9 million from 1988. The 1990 increase was due mainly to increased profits on land sales and higher earnings from property operations, partly offset by decreases in development fees and other joint venture income. The increase in 1989 was caused by an increase in profits on property sales and an improvement in equity income from joint development projects.

### CN Exploration

CN Exploration had income of $8.5 million in 1990 compared with income of $7.8 million in 1989 and $3.1 million in 1988. Increased revenues in 1990, due to higher crude oil prices and increased sales volumes, were partly offset by higher costs, mainly from increased taxes and the writing off of $2.0 million in uncollectible exploration grants. The 1989 increase was due to higher crude oil prices and a non-recurring gain on the disposal of royalty income properties partly offset by reduced sales volumes.

In the Budget tabled in the House of Commons on February 26, 1991, the Minister of Finance of Canada announced the Government's intention to privatize CN Exploration. He further indicated that proceeds from the sale of this business unit would be remitted to the Government to reduce the deficit.

### Other

Other Enterprises had income of $12.2 million in 1990, down $5.0 million from 1989, but up $1.8 million from the 1988 level. The 1990 reduction was due to lower income from Canac International Inc., CN France and CN Tower partly offset by improved results from CN Communications. Increased income from Canac International Inc., CN Communications and CN France accounted for the 1989 improvement.

## INCOME TAXES

There was a net recovery of $2.1 million in income taxes in 1990. Net income taxes for 1989 were reduced by the amount of $39.2 million through the utilization of the remainder of the Company's tax benefits pertaining to prior years' losses, and resulted in a charge against income of $51.0 million. For 1988, there was a net income tax expense of $4.3 million after the application of tax benefits of $107.1 million. See Note 11 of Notes to Consolidated Financial Statements.

## LIQUIDITY AND CAPITAL RESOURCES

Because of the recessionary conditions during 1990, cash from operating activities was insufficient to cover capital expenditures, dividends and the reduction of long-term debt, and as a result, the Company's net cash position decreased by $242.8 million. Cash deficiencies are financed by short-term bank borrowings. At December 31, 1990, short-term bank loans amounted to Canadian $91.1 million. The Company has arrangements with a number of Canadian and U.S. banks which provide lines of credit in excess of the Company's short-term borrowing requirements.

During 1990, the Company entered into conditional sales agreements and capital leases which added $10.4 million to long-term debt. The Company repaid $82.7 million in long-term debt during the year, consisting mainly of contractual obligations and sinking fund requirements. As a result of the debt reduction and an increase in retained earnings, the Company's long-term debt ratio decreased to 34.4% at December 31, 1990, from the 1989 year-end level of 35.3%.

Overall Company indebtedness, comprising long-term debt (including current portion) and bank indebtedness, less cash and time deposits, increased from $1,801.2 million to $1,973.5 million.

Planned capital expenditures for 1991 are approximately $455 million. In addition, the Company anticipates that capital expenditures for 1992 through 1995 will aggregate approximately $2.6 billion, and will include funds required for renewal of the basic plant, purchase of rolling stock and other equipment, real estate development and improvement of operating efficiency. The Company expects that although the major portion of these expenditures will be funded internally, the aggregate of capital expenditures, together with provision for debt maturities in the period, may require further borrowings.

As at December 31, 1990, the Company had commitments to purchase railway ties at an aggregate cost of $8.7 million and rail at a cost of $21.1 million.

The accompanying consolidated financial statements of Canadian National Railway System and all information in this annual report are the responsibility of management and have been approved by the board of directors.

The financial statements have been prepared by management in conformity with Canadian generally accepted accounting principles. These statements include some amounts that are based on best estimates and judgments. Financial information used elsewhere in the annual report is consistent with that in the financial statements.

Management of the Company, in furtherance of the integrity and objectivity of data in the financial statements, has developed and maintains a system of internal accounting controls and supports an extensive program of internal audits. Management believes that this system of internal accounting controls provides reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements and that assets are properly accounted for and safeguarded.

The board of directors carries out its responsibility for the financial statements in this report principally through its audit committee, consisting solely of outside directors. The audit committee reviews the Company's annual consolidated financial statements and recommends their approval by the board of directors. Also, the audit committee meets regularly with the Vice-President Internal Audit and with the Shareholder's Auditors, appointed by the Government of Canada.

These consolidated financial statements have been examined by the Shareholder's Auditors, Deloitte & Touche and Raymond, Chabot, Martin, Paré, whose report is presented below.

Yvon H. Masse
Senior Vice-President and
Chief Financial Officer

## AUDITORS REPORT

Deloitte & Touche

RAYMOND, CHABOT, MARTIN, PARE

To the Minister of Transport
Ottawa, Canada

We have audited the consolidated balance sheets of Canadian National Railway System as at December 31, 1990 and 1989 and the consolidated statements of income, retained earnings and changes in financial position for each of the years in the three-year period ended December 31, 1990. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the System as at December 31, 1990 and 1989 and the results of its operations and the changes in its financial position for each of the years in the three-year period ended December 31, 1990 in accordance with generally accepted accounting principles.

Deloitte & Touche
Chartered Accountants
(For the years ended December 31, 1990, 1989 and 1988)

Montreal, Quebec
March 5, 1991

Raymond, Chabot, Martin, Paré
Chartered Accountants
(For the year ended December 31, 1990)

Montreal, Quebec
March 5, 1991

YEAR ENDED DECEMBER 31
(IN THOUSANDS)

| | | 1990 | 1989 | 1988 |
|---|---|---|---|---|
| **CN Rail** | Revenues | $3,398,175 | $3,528,331 | $3,792,115 |
| | Expenses | 3,498,337 | 3,403,307 | 3,571,430 |
| | Income (loss) | (100,162) | 125,024 | 220,685 |
| **Grand Trunk Corporation** | Revenues | 431,147 | 461,312 | 477,816 |
| | Expenses | 441,729 | 447,625 | 464,882 |
| | Income (loss) | (10,582) | 13,687 | 12,934 |
| **Enterprises group:** | | | | |
| CN Real Estate | Revenues | 130,047 | 101,827 | 54,741 |
| | Expenses | 46,812 | 34,786 | 20,486 |
| | Other income | 12,435 | 25,949 | 12,557 |
| | Income | 95,670 | 92,990 | 46,812 |
| CN Exploration | Revenues | 38,962 | 30,283 | 27,568 |
| | Expenses | 30,474 | 22,475 | 24,428 |
| | Income | 8,488 | 7,808 | 3,140 |
| Other | Income | 12,250 | 17,273 | 10,471 |
| Total Enterprises group | | 116,408 | 118,071 | 60,423 |
| Income from continuing operations before unusual item and income taxes | | 5,664 | 256,782 | 294,042 |
| Premium on early extinguishment of long-term debt | | – | – | (111,106) |
| Income from continuing operations before income taxes | | 5,664 | 256,782 | 182,936 |
| Income taxes | | (2,070) | 51,031 | 4,349 |
| Net income from continuing operations | | 7,734 | 205,751 | 178,587 |
| Discontinued operations | | – | – | 104,078 |
| **Net income** | | $ 7,734 | $ 205,751 | $ 282,665 |

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31
(IN THOUSANDS)

| | | | 1990 | | 1989 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Current | Cash and time deposits | | $ – | | $ 128,824 |
| | Accounts receivable | | 449,598 | | 431,955 |
| | Material and supplies | | 260,032 | | 251,156 |
| | Other | | 280,094 | | 270,573 |
| | | | 989,724 | | 1,082,508 |
| Investments | | | 135,772 | | 106,495 |
| Properties | | | 5,809,887 | | 5,814,073 |
| Other Assets and Deferred Charges | | | 92,885 | | 102,275 |
| | | | $7,028,268 | | $7,105,351 |
| **Liabilities** | | | | | |
| Current | Bank indebtedness | | $ 114,050 | | $ 100 |
| | Accounts payable and accrued charges | | 826,974 | | 850,277 |
| | Current portion of long-term debt | | 103,055 | | 59,990 |
| | Other | | 263,172 | | 311,092 |
| | | | 1,307,251 | | 1,221,459 |
| Other Liabilities and Deferred Credits | | | 380,811 | | 425,632 |
| Deferred Income Taxes | | | 33,823 | | 44,570 |
| Long-Term Debt | | | 1,756,395 | | 1,869,889 |
| Minority Interest in Subsidiary Companies | | | 4,345 | | 4,345 |
| Shareholder's Equity | | | | | |
| | Capital stock | $2,278,867 | | $2,278,867 | |
| | Retained earnings | 1,266,776 | 3,545,643 | 1,260,589 | 3,539,456 |
| | | | $7,028,268 | | $7,105,351 |

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

On behalf of the board:
Brian R.D. Smith, Director
Ronald E. Lawless, Director

## CONSOLIDATED STATEMENT OF RETAINED EARNINGS

YEAR ENDED DECEMBER 31
(IN THOUSANDS)

| | 1990 | 1989 | 1988 |
|---|---|---|---|
| **Balance, beginning of year** | $1,260,589 | $1,095,988 | $ 822,212 |
| Prior years' dividends reversed | – | – | 47,644 |
| Net income | 7,734 | 205,751 | 282,665 |
| Dividend | (1,547) | (41,150) | (56,533) |
| **Balance, end of year** | $1,266,776 | $1,260,589 | $1,095,988 |

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

YEAR ENDED DECEMBER 31
(IN THOUSANDS)

| | 1990 | 1989 | 1988 |
|---|---|---|---|
| Operating activities: | | | |
| Net income from continuing operations | $ 7,734 | $ 205,751 | $ 178,587 |
| Non-cash charges to income: | | | |
| Depreciation and amortization | 269,444 | 264,766 | 261,910 |
| Income of equity investees less dividends | (14,634) | (29,255) | (16,998) |
| Deferred income taxes (recovery) | (10,747) | 44,570 | - |
| Changes in working capital items* | (50,730) | 34,735 | (40,542) |
| Other | (44,008) | (55,323) | (32,989) |
| **Cash from continuing operations** | 157,059 | 465,244 | 349,968 |
| **Cash from discontinued operations** | - | - | 14,333 |
| | 157,059 | 465,244 | 364,301 |
| Investing activities: | | | |
| Additions to properties | (327,175) | (370,960) | (386,319) |
| Net proceeds from disposal of properties | 61,916 | 62,560 | 71,600 |
| Investments in unconsolidated affiliates | (24,472) | (23,204) | (15,539) |
| Advances from unconsolidated affiliates | 17,513 | 21,323 | 6,612 |
| Repayment of advances by unconsolidated affiliates | 1,194 | 1,538 | 964 |
| Proceeds from sale of business units | - | - | 882,283 |
| Working capital of previously consolidated companies | - | - | (18,642) |
| Investments in previously consolidated companies | - | - | (13,259) |
| | (271,024) | (308,743) | 527,700 |
| Dividend paid to shareholder | (56,533) | - | - |
| **Cash provided (used) before financing activities** | (170,498) | 156,501 | 892,001 |
| Financing activities: | | | |
| Issuance of long-term debt | 10,396 | 14,381 | 5,772 |
| Reduction of long-term debt | (82,672) | (78,344) | (798,327) |
| | (72,276) | (63,963) | (792,555) |
| **Net increase (decrease) in cash** | (242,774) | 92,538 | 99,446 |
| **Cash (bank indebtedness), beginning of year** | 128,724 | 36,186 | (63,260) |
| **Net cash (bank indebtedness), end of year** | $ (114,050) | $ 128,724 | $ 36,186 |

* EXCLUDING CASH, BANK INDEBTEDNESS, CURRENT PORTION OF LONG-TERM DEBT, AND DIVIDEND PAID

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

**NOTE 1:**
**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Introduction**
All references in these Notes to the "Company" refer to Canadian National Railway Company which is wholly-owned by the Government of Canada and, unless the context otherwise requires, its consolidated subsidiaries, and all references to the "System" mean Canadian National Railway Company and its consolidated subsidiaries together with the lines of railway and other property entrusted by the Government of Canada to the Company for management and operation.

**a) Principles of Consolidation**
The consolidated financial statements include the accounts of all significant subsidiaries and, consistent with the legislation governing the System, the accounts of the Canadian Government Railways entrusted to the Company by the Government of Canada.

Investments in entities in which the Company has less than a majority interest are accounted for by the equity method, where appropriate.

**b) Reporting by Division**
In presenting the results by division, interdivisional charges for services have not been eliminated. Consolidated net income is not affected by this practice.

**c) Material and Supplies**
The inventory is valued at laid down cost based on weighted average cost for ties and rails, latest invoice price for fuel and new materials in stores, and at estimated utility or sales value for usable second hand, obsolete and scrap materials.

**d) Properties**
Accounting for railway properties is carried out in accordance with rules issued by the National Transportation Agency of Canada (Canadian properties) and the Interstate Commerce Commission (United States properties). Generally, major additions and replacements are capitalized and interest costs are charged to expense.

The cost of depreciable railway assets retired or disposed of, less salvage, is charged to accumulated depreciation, in accordance with the group plan of depreciation. Other depreciable assets retired or disposed of are accounted for in accordance with the unit plan whereby gains or losses are taken into income as they occur.

The Company follows the successful efforts method of accounting for its oil and gas operations whereby the acquisition costs of oil and gas properties, the costs of successful exploratory wells and the costs of drilling and equipping development wells are capitalized.

CN Real Estate's properties are stated at cost. Carrying costs of properties under development are capitalized. Such costs include real estate taxes, insurance, interest and other expenses directly related to the development activity.

**e) Depreciation**
Depreciation is calculated at rates sufficient to write off properties over their estimated useful lives, generally on a straight-line basis. For railway properties, rates are authorized by the National Transportation Agency of Canada and the Interstate Commerce Commission. The rates for significant classes of assets are as follows:

| | Annual Rate |
|---|---|
| Ties | 2.71%-2.73% |
| Rails | 1.93% |
| Other track material | 2.23%-2.83% |
| Ballast | 3.27% |
| Road locomotives | 4.30% |
| Freight cars | 1.73%-3.18% |

Acquisition costs of oil and gas properties are amortized on a straight-line basis over the term of the lease until such time as the properties are determined to be productive or judged to be impaired. Acquisition costs of productive properties and costs of successful exploratory drilling and of drilling and equipping development wells are charged against income on the unit-of-production method based upon proven reserves of oil and gas. Exploratory dry hole and acquisition costs judged to be impaired are charged against income in the current period. Other exploratory expenditures are charged against income as incurred.

CN Real Estate assets are depreciated using the straight-line method calculated over the estimated economic life of the asset.

**f) Revenues**
Transportation: Revenues are generally recognized on completion of movements, with interline movements being treated as complete when the shipment is turned over to the connecting carrier. Costs associated with movements not completed are deferred.

Real estate: Rental revenues are recognized as earned. Revenues from disposition of properties are recognized on completion of the sale. The share of income from joint ventures is recognized on an equity basis and reported as Other income.

**g) Pensions**
Pension costs are determined periodically by independent actuaries. Pension expense is charged annually to operations and comprises the total of the following:

- the cost of pension benefits provided in exchange for employees' services rendered during the year, and
- amortization of past service costs over the expected average remaining service life of the employee group covered by the plans.

The pension plans are funded through contributions determined in accordance with the accrued benefit actuarial cost method.

**NOTE 1:**
**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**

**h) Foreign Exchange**

The Company's foreign operations are classified as integrated and are translated and accounted for on the following bases. Current assets (excluding material and supplies), current liabilities and long-term debt are translated at the rates in effect at the balance sheet date, whereas all other assets and liabilities are translated at historical rates. Revenues and expenses are translated at average rates during the year except for depreciation which is translated at exchange rates prevailing when the related properties were acquired.

The Company's own foreign denominated assets and liabilities are accorded similar treatment. Revenues and expenses are translated at rates prevailing at the time of the transactions except for revenues designated as a hedge against repayment of foreign denominated long-term debt which are translated at the rate in effect at the inception of the debt.

Currency gains and losses are reflected in net income for the year, except for unrealized foreign currency losses on long-term debt. The Company has designated future U.S. dollar revenue streams as a hedge against the repayment of most of its long-term debt denominated in U.S. dollars, and has thus deferred reflecting the related unrealized foreign currency translation losses in net income until the earlier of the debt repayment or the expiry of the hedge. Unrealized foreign currency losses related to long-term debt denominated in U.S. dollars not covered by the hedge are deferred and amortized over the remaining life of the debt. Such deferred amounts are included in the Consolidated Balance Sheet as part of Other Assets and Deferred Charges.

**i) Leases**

Leases which satisfy the criteria for capital leases and which have been entered into after 1981 have been capitalized. Other leases entered into prior to 1982, satisfying the criteria for capital leases, have been recorded as operating leases.

**NOTE 2:**
**CHANGES IN ACCOUNTING POLICIES**

During 1990 the Company adopted retroactively the recommendations of the Canadian Institute of Chartered Accountants relating to discontinued operations and extraordinary items. The principal features of the recommendations are a much narrower definition of the nature of transactions qualifying as extraordinary items and the requirement to disclose results of discontinued operations separately from those of continuing operations. These changes result mainly in the inclusion in the income statement caption "Income taxes" of reductions in income taxes resulting from the application of prior years' losses and in "Discontinued operations" of certain 1988 asset write-downs, closure costs and gains on disposal of business units, net of related income taxes. These amounts had previously been treated as extraordinary items. The changes have no impact on reported net income.

**NOTE 3:**
**INVESTMENTS**

| | Percentage of Voting Interest | DECEMBER 31 1990 | DECEMBER 31 1989 |
|---|---|---|---|
| | | (IN THOUSANDS) | |
| Entities accounted for by equity method: | | | |
| CNCP Niagara-Detroit Partnership | 50% | $ 18,646 | $ 17,766 |
| The Toronto Terminals Railway Company | 50% | 10,682 | 10,682 |
| Other | | 50,828 | 36,494 |
| | | 80,156 | 64,942 |
| Other investments at cost less provisions for impairment where applicable | | 55,616 | 41,553 |
| Total | | $ 135,772 | $ 106,495 |

**NOTE 4:**
**PROPERTIES**

| | DECEMBER 31, 1990 | | | DECEMBER 31, 1989 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Depreciation | Net | Cost | Accumulated Depreciation | Net |
| | (IN THOUSANDS) | | | (IN THOUSANDS) | | |
| CN Rail | $8,488,536 | $3,317,177 | $5,171,359 | $8,356,990 | $3,172,380 | $5,184,610 |
| Grand Trunk Corporation | 526,394 | 145,682 | 380,712 | 522,984 | 144,485 | 378,499 |
| Enterprises group: | | | | | | |
| CN Real Estate | 161,983 | 22,736 | 139,247 | 151,169 | 18,571 | 132,598 |
| CN Exploration | 125,328 | 61,804 | 63,524 | 114,846 | 53,368 | 61,478 |
| Other | 75,737 | 20,692 | 55,045 | 79,773 | 22,885 | 56,888 |
| | $9,377,978 | $3,568,091 | $5,809,887 | $9,225,762 | $3,411,689 | $5,814,073 |
| Amounts included above with respect to Canadian Government Railways entrusted to the Company by the Government of Canada | $1,043,036 | $ 579,815 | $ 463,221 | $1,019,199 | $ 554,399 | $ 464,800 |

At December 31, 1990 the gross value of assets under capital leases included above was $97.4 million (1989 – $103.7 million) and related accumulated amortization thereon amounted to $18.9 million (1989 – $16.0 million).

NOTE 5:
LONG-TERM DEBT

| | | | Maturity | Currency in which Payable | DECEMBER 31 1990 | DECEMBER 31 1989 |
|---|---|---|---|---|---|---|
| | | | | | (IN THOUSANDS) | |
| **Bonds, Debentures and Notes** | | | | | | |
| Canadian National Notes | 11 3/8% | 8 Year | June 11, 1993 | Canadian | $ 100,000 | $ 100,000 |
| Canadian National Notes | 9 7/8% | 8 Year | Mar. 18, 1994 | Canadian | 100,000 | 100,000 |
| Canadian National Notes | 12 1/2% | 10 Year | Apr. 15, 1995 | Canadian | 100,000 | 100,000 |
| Canadian National Japanese Yen Notes (a) | 6 1/2% | 10 Year | Mar. 26, 1996 | Canadian | 70,000 | 70,000 |
| Canadian National Notes | 9 3/8% | 10 Year | Oct. 1, 1996 | Canadian | 100,000 | 100,000 |
| Canadian National Sinking Fund Debentures | 9 1/4% | 20 Year | Mar. 15, 1998 | United States | 44,511 | 62,315 |
| Canadian National Swiss Franc Bonds (b) | 5 3/8% | 15 Year | Aug. 22, 2000 | Canadian | 98,617 | 98,617 |
| Canadian National Notes | 8 7/8% | 15 Year | May 21, 2001 | Canadian | 150,000 | 150,000 |
| Canadian National Sinking Fund Debentures | 8 3/8% | 25 Year | July 1, 2002 | United States | 63,561 | 68,858 |
| Canadian National Sinking Fund Debentures | 9.70% | 25 Year | July 15, 2004 | United States | 152,781 | 163,861 |
| Canadian National Sinking Fund Debentures | 13% | 20 Year | Nov. 15, 2004 | Canadian | 86,928 | 90,196 |
| Canadian National Sinking Fund Debentures | 12 1/4% | 20 Year | May 1, 2005 | Canadian | 125,000 | 125,000 |
| Canadian National Sinking Fund Debentures | 14% | 25 Year | Jan. 15, 2006 | United States | 84,158 | 95,028 |
| Canadian National Sinking Fund Debentures | 15% | 25 Year | June 1, 2006 | United States | 77,230 | 84,328 |
| Canadian National Sinking Fund Debentures | 16 1/4% | 25 Year | Mar. 1, 2007 | United States | 55,695 | 87,180 |
| Canadian National Sinking Fund Debentures | 14 3/4% | 30 Year | Sept. 1, 2012 | United States | 55,722 | 55,722 |
| Canadian National Sinking Fund Debentures | 12% | 30 Year | Mar. 15, 2013 | United States | 122,548 | 122,548 |
| Buffalo and Lake Huron 1st Mortgage Bonds | 5 1/2% | | Perpetual | Sterling | 795 | 795 |
| Buffalo and Lake Huron 2nd Mortgage Bonds | 5 1/2% | | Perpetual | Sterling | 1,228 | 1,228 |
| Total Bonds, Debentures and Notes | | | | | 1,588,774 | 1,675,676 |
| **Government of Canada Loan (c)** | | | | | 147,634 | 161,085 |
| **Other** | | | | | | |
| Amounts owing under equipment purchase agreements (d) | | | | Various | 93,120 | 105,592 |
| Syndicated loan (e) | | | | Canadian | 42,610 | 42,610 |
| Capital lease obligations (f) | | | | Various | 88,449 | 90,733 |
| Adjustment to current exchange rate (see Note 1 h)) | | | | | (14,532) | (12,074) |
| Total Other | | | | | 209,647 | 226,861 |
| | | | | | 1,946,055 | 2,063,622 |
| Less: In-substance defeasance (g) | | | | | 74,091 | 123,545 |
| Current portion of long-term debt | | | | | 103,055 | 59,990 |
| Unamortized discount and other | | | | | 12,514 | 10,198 |
| | | | | | 189,660 | 193,733 |
| Long-Term Debt | | | | | $1,756,395 | $1,869,889 |

a) The Company borrowed $70.0 million at an all-inclusive cost of 10.25% by means of a Euro-yen public note issue and a currency swap.

b) The Company borrowed $98.6 million at an all-inclusive cost of 11.17% by means of a public bond issue in Switzerland and a currency swap.

c) The Government of Canada loan bears interest at 8 3/4% per annum and is payable in equal semi-annual instalments of $13.63 million covering principal and interest to June 30, 1998.

d) Secured by rolling stock and payable by semi-annual or quarterly instalments over various periods to 2000 at interest rates ranging from 8 1/2% to 17 3/4%. As at December 31, 1990, the principal amounts are payable as U.S. $57.2 million and Canadian $22.7 million (December 31, 1989 – U.S. $77.1 million, Canadian $14.4 million).

e) The Company borrowed $42.6 million at an all-inclusive cost of 11.535% by means of a yen syndicated loan and currency swap.

f) Interest rates for these leases range from approximately 7 7/8% to 14 1/2% with expiry dates occurring during the years 1991 through 2005. The imputed interest on these leases amounts to $73.9 million (1989 – $79.0 million).

g) Certain of the Company's long-term debt is considered to be extinguished as a result of the Company's having placed in irrevocable trusts, government securities sufficient to satisfy the interest and maturing principal requirements of the specific debt obligations involved.

**NOTE 5:**
**LONG-TERM DEBT (CONT'D)**

h) Principal repayments, including sinking fund repayments, repurchase arrangements and capital lease repayments, on debt outstanding at December 31, 1990, are as follows:

| YEAR ENDING DECEMBER 31: | (IN THOUSANDS) |
|---|---|
| 1991 | $103,055 |
| 1992 | 96,273 |
| 1993 | 174,171 |
| 1994 | 210,178 |
| 1995 | 242,725 |
| 1996-2000 | 575,010 |
| 2001-2005 | 405,091 |
| 2006-2010 | 26,098 |
| 2011-2015 | 22,038 |

**NOTE 6:**
**SHAREHOLDER'S EQUITY**

**a) Capital Stock**

The capital stock of Canadian National Railway Company, $2,278,866,774, consists of 5,868,786 common shares of no par value authorized, issued and outstanding which are owned by the Government of Canada.

**b) Retained Earnings**

Under its governing legislation, the Company is required to pay to the Receiver General for Canada a dividend equal to 20% of net income for the year or such greater percentage as the Governor in Council may direct. Accordingly, a dividend representing 20% of the net income for the year has been accrued and is included in Other Current Liabilities as is the dividend pertaining to 1989 net income. The dividend based on 1988 net income was paid during 1990. The dividends accrued on 1985 and 1987 income, which had not yet been paid, were reversed and transferred to retained earnings in 1988 on the basis of a Treasury Board of Canada decision dated December 15, 1988.

**NOTE 7:**
**MAJOR COMMITMENTS AND CONTINGENCIES**

**a) Leases**

(i) The Company's commitments as at December 31, 1990, under leases, excluding those which have been capitalized and for which the lease obligations are recorded as long-term debt (see Note 5), are as follows:

| Non-Cancellable Leases | Pre-1982 Capital Leases | Operating Leases |
|---|---|---|
| YEAR ENDING DECEMBER 31: | (IN THOUSANDS) | |
| 1991 | $ 4,727 | $ 126,630 |
| 1992 | 3,618 | 115,462 |
| 1993 | 1,363 | 114,815 |
| 1994 | 998 | 109,199 |
| 1995 | 998 | 99,305 |
| 1996-2000 | 3,466 | 493,000 |
| 2001-2005 | 1,124 | 345,011 |
| Thereafter | - | 14,829 |
| Total minimum lease payments | 16,294 | $1,418,251 |
| Less amount representing imputed interest | 3,987 | |
| Present value of net minimum lease payments under capital leases | $12,307 | |

A significant portion of the leases is in respect of railway rolling stock and many of them provide renewal options and an option to purchase the property at fair market value at the end of the lease terms.

(ii) Rental expenses under all lease arrangements which have not been capitalized were:

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | |
| Total expenses | $138,584 | $140,628 | $154,719 |
| Expenses under pre-1982 capital leases included in total expenses | $ 9,023 | $ 22,909 | $ 30,347 |

(iii) Increases in income, assets and liabilities in the consolidated financial statements, which would have arisen if leases entered into prior to 1982 and which satisfied the criteria for capital leases had been capitalized, are as follows:

**NOTE 7:**
**MAJOR COMMITMENTS AND CONTINGENCIES (CONT'D)**

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | |
| Increase in Net Income | $ 1,940 | $ 4,925 | $ 8,498 |
| Increase in Assets | | | |
| Properties | | | |
| Leased properties under capital leases | $ 46,265 | $ 98,706 | $203,454 |
| Less accumulated amortization | 34,981 | 85,363 | 180,223 |
| | 11,284 | 13,343 | 23,231 |
| Other assets and deferred charges | | | |
| Unamortized deferred exchange loss | 582 | 977 | 3,753 |
| | $ 11,866 | $ 14,320 | $ 26,984 |
| Increase in Current Liabilities | | | |
| Present value of obligations under capital leases | $ 3,761 | $ 6,388 | $ 22,025 |
| Increase in Non-Current Liabilities | | | |
| Present value of obligations under capital leases | $ 11,746 | $ 17,760 | $ 37,075 |
| Adjustment to current exchange rate (see Note 1 h)) | 561 | 928 | 3,641 |
| | 12,307 | 18,688 | 40,716 |
| Less current portion | 3,761 | 6,388 | 22,025 |
| | $ 8,546 | $ 12,300 | $ 18,691 |

**b) Other Commitments**
The Company has commitments at December 31, 1990, for capital expenditures of $8.7 million for railway ties and $21.1 million for rail.

**c) Contingencies**
In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries, damage to property and environmental matters. While the final outcome with respect to actions outstanding or pending at December 31, 1990 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the System's financial position.

**NOTE 8:**
**SUBSIDIES**

Revenues include the following subsidies:

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | |
| Government of Canada | | | |
| a) Payments under the Railway Act paid under authority of that Act and the related Appropriation Act in respect of certain uneconomic operations, services and prescribed rates which railways are required by the Railway Act to maintain | $ 23,180 | $ 32,818 | $ 48,854 |
| b) Maritime Freight Rates Act and Atlantic Region Freight Assistance Act subsidies | 14,383 | 17,381 | 19,971 |
| c) Sundry | - | 548 | 2,510 |
| Other assistance | - | - | 391 |
| | $ 37,563 | $ 50,747 | $ 71,726 |

**NOTE 9:**
**PENSIONS**

The Company has retirement benefit plans covering substantially all its employees under which they are entitled to benefits at retirement age generally based on compensation and length of service and/or contributions.

The actuarial valuations as at December 31, 1989, revealed a consolidated actuarial liability of $7.1 billion and a consolidated actuarial asset value of $6.6 billion. It is estimated that those amounts could approximate $7.3 billion and $6.8 billion respectively as at December 31, 1990. Subsequent actuarial valuations will determine the actual values at that date.

Annual pension costs were:

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | |
| | $123,402 | $156,552 | $165,784 |

**NOTE 10:**
**SYSTEM INTEREST EXPENSE**

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | |
| Interest on long-term debt | $207,387 | $214,272 | $318,297 |
| Interest on short-term borrowings | 4,348 | 217 | 2,431 |
| Interest income | (4,306) | (15,332) | (20,269) |
| | $207,429 | $199,157 | $300,459 |

**NOTE 11:**
**INCOME TAXES**

a) The Company's provision for income taxes is made up as follows:

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | |
| Provision for income taxes on income from continuing operations based on combined basic Canadian federal and provincial tax rate for 1990 of 40.8% (1989 – 40.8%, 1988 – 44.7%) | $ 2,313 | $104,870 | $ 81,864 |
| Increase (decrease) in taxes resulting from: | | | |
| Non-allowable portion of capital loss on early extinguishment of debt | – | – | 17,670 |
| Capital losses not allowed for current year | – | – | 12,726 |
| Non-allowable foreign exchange loss on conditional sale agreements | 258 | 414 | 686 |
| Profit on sale of land | (14,826) | (22,858) | (6,060) |
| Federal large corporations tax | 7,400 | 4,000 | – |
| Other | 2,785 | 3,815 | 4,575 |
| Application of prior years' losses | – | (39,210) | (107,112) |
| Actual provision for (recovery of) income taxes on income from continuing operations resulting in an effective rate for 1990 of 36.5% (1989 – 19.8%, 1988 – 2.3%) | $ (2,070) | $ 51,031 | $ 4,349 |
| Represented by: | | | |
| Current | $ 8,677 | $ 6,461 | $ 4,349 |
| Deferred | (10,747) | 44,570 | – |
| | $ (2,070) | $ 51,031 | $ 4,349 |

Deferred income taxes result primarily from the difference between capital cost allowance claimed for income tax and depreciation recorded for accounting purposes.

b) Investment tax credits are also available to reduce future income taxes otherwise payable until the related year of expiry as follows:

| Year of expiry: | (in millions) |
|---|---|
| 1993 | $25.9 |
| 1994 | 33.9 |
| 1995 | 29.7 |
| 1996 | 18.9 |
| 1997 | 14.0 |
| 1998 | 9.0 |

**NOTE 12:**
**DISCONTINUED OPERATIONS**

During 1988 the Company disposed of CN Hotels, the two subsidiary telephone companies and CNCP Telecommunications with the latter sale including Telecommunications Terminal Systems. In addition, TerraTransport ceased operations and incurred closure costs during that year.

a) The financial effect of these transactions was as follows:

| | CN Hotels | CN Communications | Terra-Transport | Total |
|---|---|---|---|---|
| | | (IN THOUSANDS) | | |
| Loss from operations | $ (9,137) | $(50,321) | $ (29,277) | $ (88,735) |
| Closure costs | – | – | (92,300) | (92,300) |
| Net gain on disposition | 117,922 | 167,191 | – | 285,113 |
| | $108,785 | $116,870 | $(121,577) | $104,078 |

b) The provision for income taxes on income from discontinued operations based on combined basic Canadian federal and provincial tax rate for 1988 of 44.7% was $33.9 million. This provision was offset by the application of prior years' losses.

**NOTE 13:**
**SEGMENTED INFORMATION**

**a) Geographic Areas**
Virtually all of the System's operations and assets are within Canada with the exception of Grand Trunk Corporation which operates in the United States.

**b) International Traffic**
In addition to the revenue generated by Grand Trunk Corporation, the System derives revenue from traffic originating or terminating on railroads in the United States. In 1990, such revenues approximated $604 million (1989 – $622 million, 1988 – $668 million).

**NOTE 13: SEGMENTED INFORMATION (CONT'D)**

**c) Revenues by Division**

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | |
| CN Rail | $3,398,175 | $3,528,331 | $3,792,115 |
| Grand Trunk Corporation | 431,147 | 461,312 | 477,816 |
| Enterprises group: | | | |
| CN Real Estate | 130,047 | 101,827 | 54,741 |
| CN Exploration | 38,962 | 30,283 | 27,568 |
| Other | 79,461 | 80,301 | 56,004 |
| Discontinued operations | – | – | 264,867 |
| | $4,077,792 | $4,202,054 | $4,673,111 |

**d) Identifiable Assets by Division**

| | DECEMBER 31 | | |
|---|---|---|---|
| | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | |
| CN Rail | $6,086,633 | $6,143,025 | $6,006,443 |
| Grand Trunk Corporation | 557,807 | 591,993 | 611,912 |
| Enterprises group: | | | |
| CN Real Estate | 218,502 | 218,216 | 141,140 |
| CN Exploration | 71,035 | 70,288 | 65,239 |
| Other | 94,291 | 81,829 | 81,301 |
| | $7,028,268 | $7,105,351 | $6,906,035 |

**e) Capital Expenditures and Depreciation by Division**

| | Capital Expenditures* | | | Depreciation | | |
|---|---|---|---|---|---|---|
| | YEAR ENDED DECEMBER 31 | | | YEAR ENDED DECEMBER 31 | | |
| | 1990 | 1989 | 1988 | 1990 | 1989 | 1988 |
| | (IN THOUSANDS) | | | | | |
| CN Rail | $ 285,336 | $ 293,816 | $ 283,723 | $ 244,029 | $ 239,020 | $ 234,794 |
| Grand Trunk Corporation | 20,670 | 18,194 | 14,370 | 13,675 | 14,494 | 14,157 |
| Enterprises group: | | | | | | |
| CN Real Estate | 6,430 | 44,487 | 28,560 | 1,844 | 1,419 | 1,102 |
| CN Exploration | 12,634 | 13,302 | 9,868 | 8,534 | 8,138 | 9,798 |
| Other | 2,105 | 1,161 | 185 | 1,363 | 1,696 | 1,880 |
| Discontinued operations | – | – | 49,613 | – | – | 31,789 |
| | $ 327,175 | $ 370,960 | $ 386,319 | $ 269,445 | $ 264,767 | $ 293,520 |

*Represent additions to properties.

**NOTE 14: OTHER MATTERS**

a) The Company carries on ordinary business transactions with various entities controlled by the Government of Canada on the same terms and conditions as current transactions with unrelated parties.

In addition, the Company provides, under contractual arrangements, rail transportation and maintenance services to the Government of Canada and to entities controlled by the latter. The revenue derived from such services rendered in 1990 aggregated $102.1 million (1989 – $101.5 million, 1988 – $103.3 million).

b) Following enactment of the Western Grain Transportation Act, which became effective on January 1, 1984, the Government of Canada, in order to minimize the cost to grain shippers, pays a portion of the cost of shipping grain. Amounts received from the Government of Canada under the Western Grain Transportation Act amounted to $335.3 million in 1990 (1989 – $332.6 million, 1988 – $416.0 million), a reflection principally of the volume of grain handled.

c) On October 10, 1990, the Company announced an enhanced separation benefits package to encourage up to 1,500 management and administrative personnel to leave the Company through early retirement or voluntary departure. The plan has an estimated potential total cost approximating $100 million. To December 31, 1990, approximately 300 employees' applications for such benefits had been accepted and related costs of $20.3 million were accrued and charged against income in 1990.

d) In the Budget tabled in the House of Commons on February 26, 1991, the Minister of Finance of Canada announced the Government's intention to privatize CN Exploration. He further indicated that proceeds from the sale of this business unit would be remitted to the Government to reduce the deficit.

**NOTE 15: RECLASSIFICATION OF COMPARATIVE FIGURES**

During 1990, changes were made to improve the classification of certain items and for comparative purposes the 1989 and 1988 figures have been reclassified.

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**Appointment of Trustee**

Following a competitive process, the Company has appointed Montreal Trust Company of Canada (Montreal Trust) as trustee of the Canadian National Railways Pension Trust Fund (Fund) effective October 1, 1990. This appointment represents one of the many initiatives undertaken by the Company in response to the Standing Committee on Transport's "Report of the Sub-Committee on Canadian National Railways' Pension System." As trustee, Montreal Trust must perform certain duties which include holding legal title to the assets of the Fund and ensuring that the Company, as administrator, complies with the provisions of the CN Pension Plan and the Pension Benefits Standards Act 1985. As a result, CN Pension Plan cheques and direct deposit statements are now issued in the name of Montreal Trust, Trustee of the CN Pension Trust Fund.

**Improvements in Pension Benefits**

The year 1990 was both the last year of the 1987-1990 program of increased pension payments and the first year for the annual guaranteed minimum pension increases flowing from the pension indexation agreement negotiated with the Railway Unions in 1989. As a result, some 38,000 retirees and surviving spouses received permanent pension increases in 1990.

In addition, effective January 1, 1989, 50% of the experience gains or losses related to pensioners are accounted for separately. These net experience gains will be used, starting January 1, 1991, exclusively to pay for indexation of pensions above the minimum up to the maximum annual amount. The maximum annual indexation to eligible retirees and survivors is 50% of the increase in the Consumer Price Index (CPI) to a maximum increase in CPI of 6% with an annual limit on the amount of pension which can be indexed. The basic eligibility requirements to qualify for indexation are to have been retired for five complete years and to have reached age 65.

**Direct Deposit – A Useful Service to Pensioners**

More and more retirees and survivors are taking advantage of the Direct Deposit System (DDS) which is available free of charge to all retirees and survivors. Under that system the monthly pension benefit is deposited directly in the individual's personal account and an itemized pension pay stub is sent to the beneficiary. Approximately 75% of all beneficiaries (67% in 1989) now use the Direct Deposit System.

MONTREAL TRUST

To: The Administrator and the members of the CN 1935 Pension Plan and the CN Pension Plan.

We, Montreal Trust Company of Canada, are the Trustee of the Canadian National Railways Pension Trust Fund ("CN Pension Trust Fund"). As Trustee, we have examined the systems, procedures and internal controls used in respect of the custody, investment, and administration of the assets of the CN Pension Trust Fund, the administration of the CN 1935 Pension Plan ("1935 Plan") and the CN Pension Plan, and the performance of Canadian National Railway Company ("CN") as Administrator of the 1935 Plan and the CN Pension Plan for the period from the date of our appointment, October 1, 1990 to December 31, 1990.

Our examination included such tests and procedures as we considered necessary in the circumstances taking into consideration the requirements of the Trust Deed and our experience in the Canadian pension industry.

In our opinion, based on the reasonable, but not absolute, degree of assurance obtained from our examination, the aforementioned systems, procedures and internal controls, used by CN as Administrator, operated effectively during the period from the date of our appointment, October 1, 1990 to December 31, 1990, and complied with the requirements of the Pension Benefits Standards Act, 1985 and its Regulations.

Montreal Trust Company of Canada
Trustee of the Canadian National
Railways Pension Trust Fund.

Montreal, March 5, 1991

## CONSOLIDATED STATEMENT OF NET ASSETS

AS AT DECEMBER 31
(IN THOUSANDS)

| | 1990 | 1989 |
|---|---|---|
| Bonds – quoted market value | | |
| 1990 – $2,788,516 1989 – $2,752,571 | $2,775,434 | $2,626,634 |
| Mortgages | 148,037 | 177,340 |
| Real estate | 424,572 | 436,967 |
| Oil and gas | 192,322 | 160,693 |
| Equities – quoted market value | | |
| 1990 – $2,744,852 1989 – $3,030,920 | 2,298,392 | 2,040,801 |
| Accounts receivable – Canadian National Railways | 7,402 | 7,221 |
| Cash and short-term investments | 115,664 | 254,813 |
| | 5,961,823 | 5,704,469 |
| Less: Other net liabilities | 25,183 | 37,039 |
| | $5,936,640 | $5,667,430 |

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

## AUDITORS' REPORT

To The Minister of Transport,
Ottawa, Canada

We have audited the Consolidated Statement of Net Assets of the Canadian National Railways Pension Trust Fund as at December 31, 1990 and the Consolidated Statement of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Administrator. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Administrator, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Canadian National Railways Pension Trust Fund as at December 31, 1990 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

Mallette Maheu

Chartered Accountants
Montreal, March 5, 1991

YEAR ENDED DECEMBER 31

(IN THOUSANDS)

| | 1990 | 1989 |
|---|---|---|
| Net assets, beginning of year | $5,667,430 | $5,384,802 |
| Net investment income | 529,793 | 520,082 |
| Contributions by employees | 87,356 | 86,014 |
| Contributions by Company | 123,733 | 157,033 |
| Total additions | 740,882 | 763,129 |
| Pension benefits paid | 462,490 | 438,361 |
| Refunds | 24,690 | 26,294 |
| Total deductions | 487,180 | 464,655 |
| Net increase before transfers | 253,702 | 298,474 |
| Transfers | 15,508 | (15,846) |
| Net increase | 269,210 | 282,628 |
| Net assets, end of year | $5,936,640 | $5,667,430 |

On behalf of the board:

Brian R. D. Smith, Director

Ronald E. Lawless, Director

## ACTUARY'S REPORT

To the Trustee
Canadian National Railways Pension Trust Fund

We have conducted actuarial valuations as at December 31, 1989, for the CN Pension Plan and the CN 1935 Pension Plan. These valuations are in accordance with generally accepted actuarial principles and the Recommendations of the Canadian Institute of Actuaries.

As at December 31, 1989, these valuations revealed a consolidated actuarial liability of approximately $7.1 billion, a consolidated unfunded actuarial liability of approximately $0.5 billion and required consolidated Company contributions which represented $123.7 million in 1990. The next actuarial valuations will be conducted as at December 31, 1992, at the latest.

In my opinion,

- the data on which these valuations were based were sufficient and appropriate for purposes of the valuations;
- the assumptions used were adequate and appropriate for the valuations; and
- the methods employed in the valuations were consistent with sound actuarial principles.

Bernard Morency
Fellow of the Canadian Institute of Actuaries

William M. Mercer Limitée
Montreal, February 15, 1991

**NOTE 1:**
**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**a) Principles of Consolidation**
The consolidated financial statements include the accounts of the Canadian National Railways Pension Trust Fund and its wholly-owned companies and encompass the CN 1935 Pension Plan and the CN Pension Plan. These plans under which benefits are generally based on compensation and length of service and/or contributions cover substantially all employees of the Canadian National Railway System.

**b) Investment Valuation**

(i) Bonds are carried at their amortized cost less deferred amounts arising from exchanges; these amounts are written off over the remaining life of the bonds sold;
(ii) Mortgages are carried at outstanding principal balances and are secured by real estate;
(iii) Real estate consists of land, buildings, and equities. Land is carried at the lower of cost and net realizable value less encumbrances, buildings at the lower of cost and net realizable value less encumbrances and accumulated depreciation calculated using the sinking fund method, and equities amounting to $243.5 million in 1990 (1989 - $241.0 million) at cost. The quoted market value of these real estate equities was $277.8 million as at December 31, 1990 (December 31, 1989 - $346.4 million);
(iv) Oil and gas properties are carried at cost as determined by the full cost method less depletion;
(v) Equities and short-term investments are carried at cost;
(vi) The quoted market value of investments in bonds and equities is based on the closing market quotations as of December 31.

**c) Determination of Contributions by the Company**
In respect of the CN 1935 Pension Plan and the CN Pension Plan, the contributions by the Company are determined in accordance with the requirements of the Pension Benefits Standards Act (1985) and regulations thereunder and are based on the accrued benefit actuarial cost method using a projection of salary. Consistent with the regulations and in addition to the current service contribution, the Company is making quarterly special payments to liquidate the unfunded actuarial liability by 2006. Also, in the case of the CN 1935 Pension Plan, the Company makes contributions as determined by the rules of the Plan.

In the latest actuarial valuations, the principal assumptions adopted by the Plans' actuary for purposes of the actuarial computations are members' mortality, disability, retirement, termination of employment, merit and periodic increases in earnings, as well as a net long-term rate of return of 7.5% per annum on investments. Future increases in members' earnings have been projected using economic assumptions consistent with this long-term rate of return.

**d) Accounting for Contributions**
Contributions from employees are recorded in the period in which the Company makes payroll deductions. The contributions from the Company as determined by the latest actuarial valuations are recorded using the accrual method.

**e) Income Determination**
Dividend income is recorded as of the ex-dividend date. Income from other investments is recorded as earned on an accrual basis.

Gain or loss on sales of equities is based on the average cost.

**f) Foreign Exchange**
Investments denominated in foreign currencies other than short-term investments are translated at historical rates of exchange. Short-term investments and the quoted market value of investments denominated in foreign currencies are translated at current rates. Foreign dividends and interest income are translated at the rates prevailing when received.

**g) Transfers**
Transfers to/from other funds are accounted for in the period in which the value of the transfers can be reasonably estimated.

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**NOTE 2:**
**TRANSFERS**

In 1990, the accounts include a provision for the amounts to be remitted to/from other funds to cover transfers of CN employees to other parties and employees of other companies transferred to CN.

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**NOTE 3:**
**LATEST ACTUARIAL VALUATIONS**

The latest actuarial valuations for the CN 1935 Pension Plan and the CN Pension Plan were as at December 31, 1989, and were submitted to the Superintendent of Financial Institutions and Revenue Canada. The consolidated actuarial liability and the consolidated unfunded actuarial liability resulting from these valuations amounted to approximately $7.1 billion and $0.5 billion respectively. Also, a market related method was used to value the assets for purposes of the actuarial valuations. This method resulted in a consolidated actuarial asset value which was adjusted to market by recognizing realized and unrealized gains over a period of five years using the straight line method. The consolidated actuarial asset value was approximately $6.6 billion as at the date of the latest actuarial valuations.

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